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NEW FLYER

2005 Annual Report

March 22, 2006

To Our Unitholders:

New Flyer Industries Inc. is pleased to present our financial results, along with those of our subsidiary, New Flyer Holdings, Inc. for the period ended January 1, 2006. The results demonstrate a stable level of revenue in spite of weakness in industry demand as well as solid growth in Adjusted EBITDA compared to the prior year, providing ongoing support for unitholder distributions. These results were achieved despite aggregate plant capacity utilization of less than 60%.

This is the first year-end period for New Flyer since our initial public offering ("IPO") of Income Deposit Securities ("IDSs") and the associated acquisition of our operating business on August 19, 2005, which gave rise to a 19-week post-closing operating period.

As a result, in order to provide you with a more meaningful assessment of our recent performance, we are also announcing results for the 13-week and combined pro forma 52-week periods ended January 1, 2006. The pro forma combined results comprise the results of the nineteen-week period since the IPO in addition to the 33-week pre-IPO period as described in the accompanying Management Discussion and Analysis ("MD&A"). For comparison purposes, these 13-week results and pro forma combined results are compared with the 13-week and 53-week periods ended January 2, 2005, as described in the accompanying MD&A. Note that all figures are in United States dollars unless stated otherwise.

Our order backlog (comprised of firm orders and options) at year-end was approximately \$2.0 billion, consistent with the level at the time of the IPO and compared to \$2.1 billion at January 2, 2005. This order position, comprised of 73.6% of U.S. orders and 26.4% of Canadian orders, continues to provide the order visibility to allow management to efficiently plan the production schedule, thereby minimizing expenses and working capital requirements.

Our results for the 52-weeks ended January 1, 2006 reflected improvement over last year's results for the longer 53-week period ended January 2, 2005.

Total revenues were \$590.8 million, down 4.2 percent from \$617.0 million in last year's 53 week period ended January 2, 2005. Revenue from bus manufacturing operations decreased 6.2% from \$572.8 million to \$537.4 million, reflecting reduced industry volume, partially offset by higher pricing. Revenue from aftermarket operations was \$53.4 million, compared to \$44.2 million last year, representing growth of 20.8%.

We believe that the reduction in industry demand for new buses in the United States in 2005 was largely the result of the temporary deferral of purchases by municipalities and local transit authorities, due to budgetary constraints at state and local levels. Management expects that this deferral of bus replacements will continue in 2006, but should lead to an increase in demand in future years, because ridership trends and government funding support the replacement and growth of the active fleet in both the United States and Canada. Our market share in 2005 has remained steady at an estimated 36%.

The strong growth in aftermarket revenue is consistent with our recent, historical performance, as New Flyer buses continue to represent a larger share of the active installed fleet in the combined United States and Canadian market. In addition, the deferral of new bus purchases, as referenced above, contributes to higher demand in the aftermarket business as customers maintain older fleets.

Adjusted EBITDA for the 52-weeks ended January 1, 2006 increased 4.3% to \$73.4 million, compared with \$70.3 million in the longer, 53-week period last year. Adjusted EBITDA margins in 2005 were 12.4% compared with 11.4% last year. Included in Adjusted EBITDA for fiscal 2005 were incremental administrative costs of \$0.8 million, which were primarily incurred in the fourth quarter, resulting from our new requirements as a publicly-traded company. Excluding these costs, which were not incurred in the prior year, our Adjusted EBITDA increased by 5.5% on a year-over-year basis.

We are pleased with the continued improvement in New Flyer's operating performance for the year. Our focus on margin improvement, evidenced in our new, innovative products and our commitment to cost containment, has resulted in strong growth in Adjusted EBITDA. This strong performance was achieved despite relatively weak overall demand in the North American transit industry resulting in reduced utilization of plant capacity. When demand rebounds, we are well positioned to capitalize.

For the combined 13-week period ended January 1, 2006, New Flyer generated revenue of \$136.7 million, compared with \$160.2 million in the corresponding period last year. Revenue from bus manufacturing operations decreased 17.3% from \$149.0 million to \$123.2 million, while revenue from aftermarket operations increased 21.1% from \$11.2 million to \$13.6 million. The respective changes reflected the overall trends evident in the full year results.

Our Adjusted EBITDA for the 13-week period ended January 1, 2006 increased 6.1% from \$16.7 million in the corresponding period of last year to \$17.7 million, while Adjusted EBITDA margins increased to 12.9% from 10.4%. The increase was the result of growth in our aftermarket operations and increased profit margins on bus sales.

On October 17, 2005, New Flyer Industries Inc. ("NFI") and New Flyer Industries Canada ULC ("NFI ULC") paid an initial distribution of C\$ 0.1301 per IDS for the period from August 19, 2005 to September 30, 2005, and we have since declared distributions at the monthly rate of C\$ 0.09167 per IDS.

For the nineteen-week period since the IPO, August 19, 2005 to January 1, 2006, our total revenue was \$208.9 million, Adjusted EBITDA was \$24.8 million and Distributable Cash was C\$ 21.1 million. Cash distributions, including distributions on Class B and Class C shares of the Company, for this period totaled C\$ 18.4 million, representing a payout ratio of 87.3% of total Distributable Cash, as described in the MD&A. (Adjusted EBITDA and Distributable Cash are defined in the MD&A.)

On behalf of the Board of Directors, management and employees of New Flyer, I thank you for your ongoing support.

John Marinucci
President and Chief Executive Officer

March 22, 2006

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS FOR THE 19-WEEKS AND THE 52-WEEKS ENDED
JANUARY 1, 2006**

Information in this Management's Discussion and Analysis of the financial condition and results of operations of the Company is supplemental to, and should be read in conjunction with, the financial statements of the Company for the period ended January 1, 2006. It also contains forward-looking statements, which are subject to a variety of factors that could cause actual results to differ materially from those contemplated by these statements. See "Forward-looking Statements". Some of the factors that could cause results or events to differ from current expectations include, but are not limited to, the factors described in the Company's public filings available on SEDAR at www.sedar.com. For additional information relating to the Company, please see the Company's Annual Information Form available on SEDAR at www.sedar.com. The financial statements have been prepared in accordance with accounting principles generally accepted in Canada ("GAAP") and, except where otherwise indicated, are presented in U.S. dollars, representing the functional currency of the Company.

MEANING OF CERTAIN REFERENCES

New Flyer Industries Inc. ("NFI"), an Ontario corporation, is the issuer of the common shares and New Flyer Industries Canada ULC ("NFI ULC", together with NFI the "Issuer"), an Alberta unlimited liability corporation, is the issuer of the Subordinated Notes, that, together with the common shares, form the income deposit securities of the Issuer ("IDSs"). As of March 21, 2006, 20,000,000 IDSs were outstanding. Each IDS represents one common share and C\$5.53 principal amount of Subordinated Notes. Unless otherwise stated or the context otherwise requires, references to the "Issuer" refer, collectively, to NFI and NFI ULC. References in this Management's Discussion and Analysis ("MD&A") to "New Flyer" or the "Company" are to Transit Holdings, Inc. ("THI") and its consolidated subsidiaries immediately prior to, and to New Flyer Holdings, Inc. ("NFL Holdings") and its consolidated subsidiaries immediately following, the consummation of the transactions described in note 1 of the consolidated financial statements of NFL Holdings for the period ended January 1, 2006 under "August 19, 2005 transaction" (the "2005 Acquisition"). References in this MD&A to "management" are to management of the Company and the Issuer.

All of the data presented in this MD&A with respect to market share, the number of heavy-duty transit buses in service and the number of heavy-duty transit buses delivered is measured in, or based on, "equivalent units". One equivalent unit represents one 30-foot, 35-foot or 40-foot heavy-duty transit bus. One articulated bus represents two equivalent units. An articulated bus is an extra long bus (55-feet to 60-feet in length), composed of two passenger compartments connected by a joint mechanism. The joint mechanism allows the vehicle to bend when the bus turns a corner, yet have a continuous interior.

Throughout this MD&A, unless otherwise indicated, all references to "GAAP" are to accounting principles generally accepted in Canada and all references to monetary amounts are to U.S. dollars (in thousands). Unless otherwise indicated, the financial information of the Issuer and the Company contained in this MD&A has been prepared in accordance with GAAP.

For the purposes of this MD&A, the financial information of NFL Holdings is not consolidated with NFI. However, all references to the Issuer or to NFI that explicitly or implicitly relate to consolidated financial

information refer to the applicable financial information with respect to NFI on an unconsolidated basis combined with and relating to NFL Holdings on a consolidated basis. The financial statements of NFI include its 100% interest in the consolidated earnings of NFL Holdings. The net earnings per share (basic and diluted) for NFI's 29-week period ending January 1, 2006 is \$0.81 per share. Additional information about the Issuer and the Company is available on SEDAR at www.sedar.com.

Forward-looking Statements

Certain statements in this MD&A are "forward-looking statements", which reflect the expectations of management regarding the Issuer's and the Company's future growth, results of operations, performance and business prospects and opportunities. The words "believes", "anticipates", "plans", "expects", "intends", "projects", "estimates" and similar expressions are intended to identify forward-looking statements. These forward-looking statements reflect management's current expectations regarding future events and operating performance and speak only as of the date of this MD&A. Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not or the times at or by which such performance or results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed in the Company's public filings available on SEDAR at www.sedar.com.

Although the forward-looking statements contained in this MD&A are based upon what management believes to be reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward-looking statements, and the differences may be material. These forward-looking statements are made as of the date of this MD&A and the Issuer and the Company assume no obligation to update or revise them to reflect new events or circumstances.

DEFINITIONS OF EBITDA, ADJUSTED EBITDA AND DISTRIBUTABLE CASH

References to "EBITDA" are to earnings before interest expense, income taxes, depreciation and amortization; losses or gains on disposal of property, plant and equipment; share-based compensation expense; unrealized foreign exchange losses or gains on non-current monetary items and forward foreign exchange contracts; fair value adjustments to other liabilities – Class B and Class C common shares; and distributions on Class B and Class C common shares. References to "Adjusted EBITDA" are to EBITDA after adjusting for: (i) the effects of certain non-recurring and/or non-operations related items that have impacted the business and are not expected to recur, including certain business disposition costs relating to the acquisition of the Company on February 27, 2004 and August 19, 2005, fair market value adjustments to inventory resulting from purchase accounting for the acquisition of the Company on February 27, 2004 and August 19, 2005, and management fees and (ii) lease costs for the period prior to October 2004 relating to a sale and leaseback of one of the Company's production facilities.

Management believes EBITDA, Adjusted EBITDA and Distributable Cash (as defined below) are useful measures in evaluating the performance of the Company and/or the Issuer. Specifically, management believes that Adjusted EBITDA is the appropriate measure from which to make adjustments to determine "Distributable Cash" (being Adjusted EBITDA decreased for maintenance capital expenditures, principal payments on capital leases, interest on the "New Credit Facility", as defined below and capital leases, interest on the Separate Subordinated Notes and cash taxes). However, EBITDA, Adjusted EBITDA and Distributable Cash are not recognized earnings measures and do not have standardized meanings prescribed by GAAP. Readers of this MD&A are cautioned that EBITDA, Adjusted EBITDA and Distributable Cash should not be construed as an alternative to net earnings or loss determined in accordance with GAAP as an indicator of the Company's and/or the Issuer's performance or to cash flows from operating, investing and financing activities

as a measure of liquidity and cash flows. A reconciliation of net earnings to EBITDA and Adjusted EBITDA based on the Company's financial statements has been provided under the heading "Reconciliation of Net Earnings to EBITDA and Adjusted EBITDA".

The Issuer's method of calculating EBITDA, Adjusted EBITDA and Distributable Cash may differ materially from the methods used by other issuers and, accordingly, may not be comparable to similarly titled measures used by other issuers. Distributable Cash is not assured, and the actual amount received by holders of IDSs will depend on, among other things, the Company's financial performance, debt covenants and obligations, working capital requirements, future capital requirements and the deductibility for U.S. federal income tax purposes of interest payments on the Subordinated Notes, all of which are susceptible to a number of risks, as described in the Company's public filings available on SEDAR at www.sedar.com.

Basis of Presentation of this MD&A

NFL Holdings began operations on August 19, 2005. The period ended January 1, 2006 includes 19 weeks of operations beginning on August 19, 2005. In order to enhance the usefulness of this MD&A, the financial results of NFL Holdings for the 19 week period ended January 1, 2006 have been combined with financial results from January 3, 2005 through August 18, 2005 of the predecessor Company to create combined pro forma operating results for the year ended January 1, 2006. (See "Basis of Financial Presentation - 2005 Acquisition" and "Unaudited Combined 2005 Financial Information"). These combined pro forma fiscal 2005 results have been compared to pro forma operating results of the Company for the 2004 fiscal year ended January 2, 2005. (See "Basis of Financial Presentation - 2004 Acquisition" and "Unaudited Combined 2004 Financial Information".) As the periods, or portions thereof, are prior to August 19, 2005, this information is provided for reference purposes only, and is not intended as a comprehensive comparison of financial results.

Overview

New Flyer is the leading manufacturer of heavy-duty transit buses in the United States and Canada and a leading provider of aftermarket parts and service. Management estimates that the Company has an approximate 36% market share of the combined United States and Canadian heavy-duty transit bus industry based on estimated industry deliveries in 2005. From its production facilities in Winnipeg, Manitoba and Crookston and St. Cloud, Minnesota, New Flyer has the broadest and most advanced product offering in the industry. For the 52-week period ended January 1, 2006, New Flyer generated revenue and Adjusted EBITDA of \$590.8 million and \$73.4 million, respectively.

The Company's order backlog as at January 1, 2006 represented approximately \$2.0 billion of revenue (including approximately \$0.6 billion in firm orders and approximately \$1.4 billion in options) compared to \$1.9 billion as at October 2, 2005 and \$2.1 billion at the end of 2004. This order position, comprised 73.6% of U.S. orders and 26.4% of Canadian orders, continues to provide the order visibility to allow the Company to efficiently plan the production schedule, thereby minimizing expenses and working capital requirements.

Revenue during fiscal 2005 of \$590.8 million has decreased 4.2% from fiscal 2004 revenue of \$617.0 million. Management believes that this reduction in revenue is attributable to a reduction in market demand for heavy-duty buses in the United States, as the Company's market share of 36% in both 2005 and 2004 has remained stable. Management believes that the reduction in industry demand in the United States is largely the result of the temporary deferral of bus purchases by municipalities and local transit authorities due to budgetary constraints at state and local levels. Management expects that this deferral of bus replacements will continue into 2006, but should lead to an increase in demand in the years to come because ridership trends and government funding support the replacement and growth of the active fleet in both the United States and Canada. Aftermarket revenue for fiscal 2005 has increased by 20.8% compared with fiscal 2004.

For the 13-week period ended January 1, 2006, New Flyer generated revenue of \$136.7 million, compared with \$160.2 million in the corresponding period last year. Revenue from bus manufacturing operations decreased 17.3% from \$149.0 million to \$123.2 million, while revenue from aftermarket operations increased 21.1% from \$11.2 million to \$13.6 million. The respective changes reflected overall trends evident in the full year results.

Adjusted EBITDA for fiscal 2005 of \$73.4 million has increased by 4.3% compared to fiscal 2004 Adjusted EBITDA of \$70.3 million. Included in Adjusted EBITDA for fiscal 2005 were incremental administrative costs of \$0.8 million, which were primarily incurred in the fourth quarter, resulting from compliance with new requirements as a public company. Normalized for these costs, which were not incurred in years prior to fiscal 2005, Adjusted EBITDA has increased by 5.5% on a year-over-year basis.

For the 13-week period ended January 1, 2006, Adjusted EBITDA of \$17.7 million has increased by 6.1% from \$16.7 million reported by the Company for the corresponding period in the prior year. Adjusted EBITDA margins increased to 12.9% from 10.4% in the prior year period. The increase was the result of growth in aftermarket operations and increased profit margins on bus sales.

Distributable Cash for the 13-week period ended January 1, 2006 was C\$15.7 million. During this period, the Company declared total distributions of C\$12.5 million, which represents 79.5% of Distributable Cash for the period.

Distributable Cash for the 19-week period ended January 1, 2006 was C\$21.1 million. Distributions declared during the 19-week period were C\$18.4 million, which represents 87.3% of Distributable Cash for the period.

SELECTED FINANCIAL AND OPERATING INFORMATION

The following selected consolidated financial and operating information of the Company has been derived from and should be read in conjunction with the historical financial statements of the Company.

	13-Weeks Ended January 1, 2006 ⁽¹⁾ (unaudited)	13-Weeks Ended January 2, 2005 ⁽²⁾ (unaudited)	52-Weeks Ended January 1, 2006 ⁽¹⁾ (unaudited)	53-Weeks Ended January 2, 2005 ⁽²⁾ (unaudited)
(US dollars in thousands, except for deliveries in equivalent units)				
Selected Statement of Earnings Data				
Revenue				
Bus manufacturing operations	\$ 123,164	\$ 148,977	\$ 537,409	\$ 572,772
Aftermarket operations	<u>13,583</u>	<u>11,220</u>	<u>53,395</u>	<u>44,219</u>
Total revenue	136,747	160,197	590,804	616,991
 Earnings from operations	 11,104	 12,414	 29,016	 48,738
Net earnings (loss)	1,479	7,085	(13,851)	8,903
EBITDA ⁽³⁾	17,003	15,972	52,983	50,314
Adjusted EBITDA ⁽³⁾	17,716	16,694	73,367	70,343
Other Data (unaudited)				
Deliveries (equivalent units) ⁽⁴⁾	353	483	1,583	1,938
Total capital expenditures	2,751	1,027	4,997	2,756
 Selected Balance Sheet Data				
Total assets			\$ 825,672	\$ 473,658
Long-term financial liabilities			622,503	237,751
Other Data (Unaudited)				
Backlog ⁽⁵⁾			\$ 1,976,262	\$ 2,071,308

Notes:

- (1) Results for the 52-weeks ended January 1, 2006 consist of the combined results of the Company for the 19-weeks ended January 1, 2006 and the 33-weeks ended August 18, 2005. See "Basis of Financial Presentation—2005 Acquisition", "Fiscal and Interim Periods" and "Unaudited Combined 2005 Financial Information".
- (2) Results for the 53-weeks ended January 2, 2005 consist of the combined results of the Company for the 44-weeks ended January 2, 2005 and the 9-weeks ended February 27, 2004. See "Basis of Financial Presentation—2004 Acquisition", "Fiscal and Interim Periods" and "Unaudited Combined 2004 Financial Information".
- (3) EBITDA and Adjusted EBITDA are not recognized earnings measures and do not have standardized meanings prescribed by GAAP. Therefore, EBITDA and Adjusted EBITDA may not be comparable to similar measures presented by other issuers. See "Definitions of EBITDA, Adjusted EBITDA and Distributable Cash". Management believes that EBITDA and Adjusted EBITDA are useful supplemental measures in evaluating performance of the Company and/or the Issuer.

- (4) One equivalent unit represents one 30-foot, 35-foot or 40-foot heavy-duty transit bus. One articulated bus represents two equivalent units.
- (5) Dollar value of the Company's backlog. Backlog is comprised of both firm orders and options.

RECONCILIATION OF NET EARNINGS TO EBITDA AND ADJUSTED EBITDA

Because the Issuer distributes substantially all of its cash on an ongoing basis, subject to certain restrictions, management believes that EBITDA and Adjusted EBITDA are important measures in evaluating the historical performance of the Company. However, EBITDA and Adjusted EBITDA are not recognized earnings measures under GAAP and do not have standardized meanings prescribed by GAAP. Accordingly, EBITDA and Adjusted EBITDA may not be comparable to similar measures presented by other issuers. Readers of this MD&A are cautioned that EBITDA and Adjusted EBITDA should not be construed as alternatives to net earnings or loss determined in accordance with GAAP as indicators of the Company's performance, or cash flows from operating activities as a measure of liquidity and cash flow. The Company defines and has computed EBITDA and Adjusted EBITDA as described under "Definitions of EBITDA, Adjusted EBITDA and Distributable Cash". The following table reconciles net earnings or losses to EBITDA and Adjusted EBITDA based on the historical consolidated financial statements of the Company for the periods indicated.

	13-Weeks Ended January 1, 2006 ⁽¹⁾ (unaudited)	13-Weeks Ended January 2, 2005 ⁽²⁾ (unaudited)	19-Weeks Ended January 1 2006 ⁽¹⁾ (unaudited)	52-Weeks Ended January 1, 2006 ⁽¹⁾ (unaudited)	53-Weeks Ended January 2, 2005 ⁽²⁾ (unaudited)
(US dollars in thousands)					
Net Earnings (Losses)	\$ 1,479	\$ 7,085	\$ 11,078	\$ (13,851)	\$ 8,903
Addback⁽³⁾					
Income taxes	(1,435)	1,541	(10,383)	14,261	11,204
Interest expense	5,271	3,573	9,256	30,030	14,906
Amortization	5,899	3,528	8,630	16,999	12,354
Loss on disposal of property, plant and equipment.....	159	116	159	143	116
Share-based compensation expense	—	437	—	8,726	2,617
Fair value adjustment to other liability— Class B and Class C Common Shares.....	—	—	(16,637)	(16,637)	—
Distributions on Class B and Class C Common Shares	5,828	—	8,588	8,588	—
Unrealized foreign exchange loss on non- current monetary items and forward foreign exchange contracts.....	(198)	(308)	4,826	4,724	214
EBITDA⁽⁴⁾	17,003	15,972	15,517	52,983	50,314
Business disposition costs ⁽⁵⁾	—	407	—	1,758	13,395
Fair market value adjustment to inventory ⁽⁶⁾	713	—	9,311	9,311	6,313
Management and transaction fees ⁽⁷⁾	—	375	—	9,315	1,506
St. Cloud lease ⁽⁸⁾	—	(60)	—	—	(1,185)
Adjusted EBITDA⁽⁴⁾	<u>\$ 17,716</u>	<u>\$ 16,694</u>	<u>\$ 24,828</u>	<u>\$ 73,367</u>	<u>\$ 70,343</u>

Notes:

- (1) Results for the 52-weeks ended January 1, 2006 consist of the combined results of the Company for the 19-weeks ended January 1, 2006 and the 33-weeks ended August 18, 2005. See “Basis of Financial Presentation — 2005 Acquisition”, “Fiscal and Interim Periods” and “Unaudited Combined 2005 Financial Information”.
- (2) Results for the 53-weeks ended January 2, 2005 consist of the combined results of the Company for the 44-weeks ended January 2, 2005 and the 9-weeks ended February 27, 2004. See “Basis of Financial Presentation — 2004 Acquisition”, “Fiscal and Interim Periods” and “Unaudited Combined 2004 Financial Information”.
- (3) Addbacks are derived from the historical financial statements of the Company.
- (4) EBITDA and Adjusted EBITDA are not recognized earnings measures and do not have standardized meanings prescribed by GAAP. Therefore, EBITDA and Adjusted EBITDA may not be comparable to similar measures presented by other issuers. See “Definitions of EBITDA, Adjusted EBITDA and Distributable Cash”. Management believes that EBITDA and Adjusted EBITDA are useful supplemental measures in evaluating performance of the Company and/or the Issuer.
- (5) Normalized to exclude non-recurring expenses related to the acquisition of the Company on February 27, 2004 and August 19, 2005.
- (6) On the acquisitions of the Company on February 27, 2004 and August 19, 2005, \$6.3 million and \$9.3 million, respectively, of the excess purchase price was allocated to inventory as a fair market value adjustment, resulting in a subsequent non-cash charge to operating costs and expenses upon the sale of the inventory.
- (7) Normalized to exclude management and transaction fees paid to related parties that were terminated after the 2005 Acquisition.
- (8) The Company entered into a sale and leaseback of the St. Cloud production facility in October 2004. Accordingly, a normalization adjustment has been made to reflect the lease cost to earnings for periods prior to the transaction.

SUMMARY OF DISTRIBUTABLE CASH OF THE ISSUER

	13-Weeks Ended <u>January 1, 2006</u> (unaudited)	19-Weeks Ended <u>January 1, 2006</u> (unaudited)
	(in thousands of US dollars, except share amounts and as indicated)	
Adjusted EBITDA ⁽¹⁾	\$ 17,716	\$ 24,828
Maintenance capital expenditures, net of proceeds on disposal of redundant assets	36	(195)
Principal portion of capital lease payments	(109)	(169)
Interest on New Credit Facility and capital leases	(1,565)	(2,571)
Interest on Separate Subordinated Notes	(982)	(1,469)
Cash taxes ⁽²⁾	(1,844)	(2,632)
Distributable Cash (US\$) ⁽¹⁾	<u>13,252</u>	<u>17,792</u>
U.S. exchange rate ⁽³⁾	1.1849	1.1840
Distributable Cash ⁽¹⁾ (C\$)	<u>15,702</u>	<u>21,066</u>
Summary of Cash Distributions: ⁽¹⁾		
Interest on Subordinated Notes forming part of IDSs (C\$)	3,871	5,701
Dividends on Common Shares forming part of IDSs (C\$)	1,629	2,400
Dividends on Class C Shares (C\$)	6,455	9,509
Dividends on Subordinated Class B Shares (C\$)	<u>524</u>	<u>772</u>
Total Cash Distributions (C\$)	<u>12,479</u>	<u>18,382</u>
Excess of Distributable Cash (C\$)	<u>\$ 3,223</u>	<u>\$ 2,684</u>
Total Cash Distributions per IDS (C\$):		
Interest on Subordinated Notes (C\$)	0.1936	0.2852
Dividend on Common Share (C\$)	<u>0.0814</u>	<u>0.1199</u>
Total Distribution per IDS (C\$) ⁽⁴⁾	<u>0.2750</u>	<u>0.4051</u>
Issued and outstanding IDSs	<u>20,000,000</u>	<u>20,000,000</u>
Dividends per Class C Shares (C\$): ⁽⁴⁾		
Preferential Dividend	0.1229	0.1811
Residual Dividend	<u>0.0814</u>	<u>0.1199</u>
Total Cash Dividend	<u>0.2043</u>	<u>0.3010</u>
Issued and Outstanding Class C Shares	<u>31,585,671</u>	<u>31,585,671</u>
Dividends per Class B Share (C\$): ⁽⁴⁾		
Preferential Dividend	0.1229	0.1811
Residual Dividend	<u>0.0814</u>	<u>0.1199</u>
Total Cash Dividend	<u>0.2043</u>	<u>0.3010</u>
Issued and Outstanding Class B Shares	<u>2,562,529</u>	<u>2,562,529</u>

Notes:

- (1) Adjusted EBITDA and Distributable Cash are not recognized measures under GAAP and do not have standardized meanings prescribed by GAAP. Therefore, Adjusted EBITDA and Distributable Cash may not be comparable to similar measures presented by other issuers. See “Definitions of EBITDA, Adjusted EBITDA and Distributable Cash” and “Reconciliation of Net Earnings to EBITDA and Adjusted EBITDA”. Management believes that Adjusted EBITDA is an important supplemental measure in evaluating the Company's and/or the Issuer's performance and is the appropriate measure from which to make adjustments to determine Distributable Cash.
- (2) Cash taxes are based on the total cash taxes paid in the period less taxes paid related to the period prior to the 2005 Acquisition.
- (3) U.S. exchange rate (US\$ per C\$) is the weighted average exchange rate of the distributions for the period.
- (4) The Issuer has declared distributions of C\$0.4051 per IDS cumulatively since closing the initial public offering on August 19, 2005 (19-week period ended January 1, 2006). These distributions represent an effective annual rate of C\$1.10 per IDS. Distributions on IDSs are paid on a monthly basis to the securityholders of record on the last business day of the previous month.

NFL Holdings has three classes of issued and outstanding common shares. All of the Class A common shares of NFL Holdings (20,000,000 issued and outstanding) are held by NFI Cumulatively, dividends of C\$0.1262 per share have been declared for the 19-week period ended January 1, 2006. These dividends are subject to withholding taxes of 5%, resulting in payment to NFI of C\$0.1199 per share for the 19-week period ended January 1, 2006. The net cash dividend received by NFI on the Class A common shares of NFL Holdings is utilized to fund the dividend on the common share component of the IDS distributions.

New Flyer Transit L.P. and management, through New Flyer LLC, (the “Existing Investors”), hold all of the issued and outstanding Class B and Class C common shares of NFL Holdings. Each Class B common share and Class C common share is entitled to a preferential dividend and residual dividend. The preferential dividend is equivalent to the interest on the subordinated debt component of the IDS distribution on a tax-adjusted basis. The residual dividend is equivalent to the dividend on the common share component of the IDS distribution. For the 19-week period ended January 1, 2006, the Company has declared preferential and residual dividends totaling C\$0.3010 per Class B and Class C common share. Dividends are declared on a quarterly basis for Class B common shares and on a monthly basis for the Class C common shares. Dividends on the Class B common shares and Class C common shares held by New Flyer Transit L.P. are calculated in Canadian dollars, but paid in U.S. dollars at a rate of 1.2038 US \$ per C\$.

Currency Impact on the Company's Reported Results

The Company's financial statements are presented in U.S. dollars. New Flyer operates in both the United States and Canada and, as a result, its combined reported results are impacted by fluctuations in the exchange rate between the Canadian dollar and the U.S. dollar. These fluctuations can represent a significant component of the variations in reported results from one period to the next.

The currency mix of cash flows and earnings depends on the geographic source of orders for heavy-duty transit buses, production, other costs and other factors which vary from period to period. During fiscal 2005, 30.7% of the Company's revenue was denominated in Canadian dollars compared to 13.3% in fiscal 2004, representing an increase of 121.6% in Canadian dollar-denominated revenue. Canadian dollar-denominated operating costs remained relatively stable at 20% and 25% during fiscal 2005 and fiscal 2004, respectively. As a result, the Company generated net Canadian dollar cash inflow in fiscal 2005. The Company's order book position consists of 26.4% of Canadian dollar-denominated revenue and therefore the Company expects to continue to generate a net Canadian dollar cash inflow in fiscal 2006.

The Company has an active hedging strategy to minimize the effects of foreign currency fluctuations. In accordance with this strategy, as at January 1, 2006 the Company has maintained the cross-currency interest rate swap entered into in August 2005 and has entered into forward foreign exchange contracts to sell C\$23.9 million, with settlement dates ranging from January 2006 to January 2007. However, as actual future revenues, expenses and resulting cash flows may vary from management's estimates, there can be no assurance that the Company's hedging strategy will mitigate the impact of foreign exchange fluctuations on operating results and cash flows.

Basis of Financial Presentation

2005 Acquisition

As a result of the 2005 Acquisition, the financial statements of the Company for the first 33-weeks of fiscal 2005 are those of THI, and the financial statements for the last 19-weeks of 2005 are those of NFL Holdings.

Accordingly, this MD&A for the Company's fiscal 2005 results has been derived from the following combined financial information:

- Fiscal 2005 — Audited consolidated financial statements of operations and cash flows of the Company for the 19-week period ended January 1, 2006 and the audited consolidated statements of operations and cash flows of THI for the 33-week period ended August 18, 2005.

See "Unaudited Combined 2005 Financial Information".

The acquisition of THI has been accounted for using the purchase method. The fair values of the identifiable assets and liabilities acquired have been based on management's best estimates and valuation techniques as at August 19, 2005. The cash purchase price of \$62.3 million and non-cash consideration consisting of Class B and Class C common shares of \$277.3 million was allocated to the assets and liabilities of THI at August 19, 2005 as follows:

(US dollars in thousands)	August 19, 2005 Transit Holdings Inc.	Acquisition / Purchase Accounting	After Purchase Accounting in NFL Holdings
Assets Acquired			
Cash	\$ 11,176	\$ —	\$11,176
Accounts receivable	48,390	—	48,390
Inventories	72,157	9,311 (i)	81,468
Prepaid expenses and deposits	7,695	191 (ii)	7,886
Property, plant and equipment	26,006	6,064 (iii)	32,070
Deferred charges	1,580	—	1,580
Intangible assets	198,659	191,241 (iv)	389,900
Goodwill	93,610	107,473 (v)	201,083
Derivative financial instruments	757	—	757
	<u>\$460,030</u>	<u>\$314,280</u>	<u>\$774,310</u>
Liabilities Assumed			
Accounts payable and accrued liabilities.....	177,902	(51,351) (vi)	126,551
Deferred revenue	15,691	—	15,691
Provision for warranty costs	19,675	—	19,675
Accrued benefit liability	1,888	1,400 (vii)	3,288
Obligations under capital lease	1,662	—	1,662
Future income tax liabilities.....	31,423	88,827 (viii)	120,250
Long-term debt.....	<u>147,632</u>	<u>—</u>	<u>147,632</u>
	<u>395,873</u>	<u>38,876</u>	<u>434,749</u>
Net assets acquired.....	<u>\$ 64,157</u>	<u>\$275,404</u>	<u>\$339,561</u>

The purchase accounting adjustments as at August 19, 2005 are summarized as follows:

- (i) Inventories have been increased by \$9.3 million to estimated fair value.
- (ii) Prepaid expenses and deposits have been increased by \$191 thousand to estimated fair value.
- (iii) Property, plant and equipment have been increased by \$6.1 million to estimated fair value.
- (iv) Intangibles have been increased by \$191.2 million to estimated fair value. Intangibles principally represent the values of patents and customer relationships, in the amount of \$88.2 million and \$170.9 million, respectively, that will be amortized over the remaining lives of those intangibles, and trade names in the amount of \$130.8 million with an indefinite life.
- (v) After allocating the cost of the purchase to identifiable assets and liabilities, goodwill was increased by \$107.5 million to the total of \$202.0 million. No amount of this goodwill is expected to be deductible for tax purposes.
- (vi) Accounts payable and accrued liabilities have been decreased by \$51.4 million to estimated fair value, which represents the reduction in stock-based compensation liability in exchange for Class B and C common shares of NFL Holdings.
- (vii) Accrued benefit liability related to the defined benefit pension plan has been increased by \$1.4 million to estimated fair value.
- (viii) Future income tax liabilities have been increased by \$88.8 million to estimated fair value.

Subsequent to the acquisition of THI the following assumed amounts were paid:

(US dollars in thousands)

Share-based compensation liability	\$17,146
Contractual debt-breakage fee	3,443
Management fee agreement termination payment	5,112
Transaction fee	3,229
Income taxes	25,296
	<u>\$54,226</u>

Of the \$23.1 million of expenses related to the acquisition, \$13.9 million was recorded as deferred financing costs, and will be amortized over 4 to 15 years based on the term of the related debt as interest expense, and \$7.5 million was charged directly against share capital of NFI for a net increase in share capital of \$66.3 million. This amount was invested in NFL Holdings by NFI upon acquisition of all of the Class A common shares of NFL Holdings. The remaining \$1.8 million of the acquisition related expenses was charged against the earnings in the period immediately prior to the 2005 Acquisition.

In course of the the preparation of the Company's annual accounts and year end audit, it was confirmed that the transaction expenses relating to the Offering were \$1.8 million in excess of the amount deducted from the proceeds of the Offering received by the Existing Investors. Following closing of the Offering, management determined that the Company was left with over \$16.5 million of excess working capital that the Existing Investors could have withdrawn prior to the closing of the Offering. The additional transaction expenses were effectively paid out of this excess working capital in accordance with the intentions of the parties at the time. Based on confirmation of the foregoing by management and parties involved in the transactions related to the Offering and a detailed consideration of the circumstances, a committee of independent and disinterested board members authorized the Company to waive the requirement under the Offering transaction agreements that the Existing Investors reimburse the Company the additional transaction expenses.

2004 Acquisition

As a result of the acquisition of the Company on February 27, 2004 (the "2004 Acquisition"), the financial statements of the Company for the last 44 weeks of fiscal 2004 are those of THI, and the financial statements for the first 9 weeks of fiscal 2004 are those of NFIL Holdings Corp.

Accordingly, this MD&A for the Company's fiscal 2004 results has been derived from the following combined financial information:

- Fiscal 2004 — Audited consolidated financial statements of operations and cash flows of THI for the 44-week period ended January 2, 2005 and the audited consolidated statements of operations and cash flows of NFIL Holdings Corp. for the 9-week period ended February 27, 2004.

See "Unaudited Combined 2004 Financial Information".

Fiscal and Interim Periods

The Company's fiscal year is based on four 13-week production periods. The following table summarizes the number of weeks in the fiscal and interim periods presented for the Company:

	Period from January 3, 2005 to January 1, 2006 (Fiscal 2005)		Period from December 29, 2003 to January 2, 2005 (Fiscal 2004)	
	Period End Date	# of Weeks	Period End Date	# of Weeks
Quarter 1	April 3, 2005	13	April 4, 2004	14
Quarter 2	July 3, 2005	13	July 4, 2004	13
Quarter 3	October 2, 2005	13	October 3, 2004	13
Quarter 4	January 1, 2006	13	January 2, 2005	13
Fiscal year	January 1, 2006	52	January 2, 2005	53

Results of Operations

The Company's operations are divided into two business segments: bus manufacturing operations and aftermarket operations. The discussion below with respect to revenue, operating costs and expenses and earnings from operations has been divided between the bus manufacturing and aftermarket operations segments.

	Fiscal 2005	Fiscal 2004
	(unaudited)	(unaudited)
	(US dollars in thousands)	
Revenue	\$ 590,804	\$ 616,991
Earnings from operations	29,016	48,738
Earnings before interest and income taxes.....	39,028	35,013
Earnings before income taxes	410	20,107
Net (loss) earnings for the period.....	(13,851)	8,903

Revenue

The consolidated revenue for fiscal 2005 of \$590.8 million decreased 4.2% from the consolidated revenue for fiscal 2004 of \$617.0 million.

Revenue from bus manufacturing operations for fiscal 2005 was \$537.4 million, a decrease of 6.2% from \$572.8 million in fiscal 2004. This decrease is attributed to an 18.3% reduction in deliveries in fiscal 2005 compared to fiscal 2004, offset by an increase in the average bus selling price due to a change in product sales mix. New Flyer lowered production rates in the last half of fiscal 2004 and has maintained these production rates during fiscal 2005 to meet industry demand. Management estimates that the Company's market share has remained stable at 36% during both fiscal 2005 and fiscal 2004. Management believes that the reduction in industry demand in the United States is largely the result of the temporary deferral of bus purchases by municipalities and local transit authorities due to budgetary constraints at state and local levels. Management expects that this deferral of bus replacements will continue into 2006, but should lead to an

increase in demand in the years to come because ridership trends and government funding support the replacement and growth of the active fleet in both the United States and Canada. The increase in average bus selling price is attributed to product mix and rising material costs that have been passed on to customers.

The revenue from aftermarket operations in fiscal 2005 was \$53.4 million compared to \$44.2 million in fiscal 2004, which represents a growth of 20.8%. This growth rate is comparable to growth in prior years as New Flyer buses continue to represent a larger share of the active installed fleet in the combined United States and Canadian market. In addition, the deferral of new bus purchases as discussed above, contributes to higher demand in the aftermarket business as customers maintain older fleets.

Operating costs and expenses

The consolidated operating costs and expenses for fiscal 2005 of \$545.6 million decreased by 1.4% from fiscal 2004 consolidated operating costs and expenses of \$553.2 million.

Operating costs and expenses from bus manufacturing operations consist of direct contract costs, manufacturing overhead and selling, general and administrative expenses. The operating costs and expenses from bus manufacturing operations for fiscal 2005 were \$484.5 million compared to \$513.6 million in fiscal 2004, a decrease of 5.7%. The 2005 Acquisition and 2004 Acquisition were accounted for using the purchase method, which resulted in \$9.3 million and \$6.3 million, respectively, of excess purchase price allocated to inventory as a fair market value adjustment. These adjustments for fiscal 2005 and fiscal 2004 were charged to bus manufacturing operating costs and expenses. Excluding these charges, bus manufacturing operating costs and expenses for fiscal 2005 and fiscal 2004 were \$475.2 million and \$507.3 million, respectively, which would have meant a decrease of 6.3% year over year. The reduction in bus manufacturing operating costs and expenses in excess of the bus revenue reduction is due to productivity gains.

The operating costs and expenses from aftermarket operations amounted to \$43.1 million in fiscal 2005 compared to \$35.4 million in fiscal 2004, representing an increase of 21.7%. This growth in expenses corresponds to the revenue growth between periods.

Unallocated operating costs and expenses consist of management fees, stock-based compensation expense, and other miscellaneous charges (recoveries). In fiscal 2005, unallocated operating costs and expenses were \$18.0 million compared to \$4.2 million in fiscal 2004. The increase of \$13.8 million is primarily due to the charges related to the termination of a management agreement and a transaction fee payable to Harvest Partners, Inc. and Lightyear Capital LLC, and the settlement of management's options, incurred as a result of the 2005 Acquisition.

Amortization

The amortization charges for fiscal 2005 in the amount of \$17.0 million increased by 37.6% compared to charges of \$12.4 million in fiscal 2004. The amortization charges for fiscal 2005 on plant and equipment were \$5.1 million, compared to \$4.9 million in fiscal 2004. Amortization charges decreased in fiscal 2005 due to the reduction in the asset base that resulted from the sale of the St. Cloud facility in October 2004, offset by the increase in amortization charges in fiscal 2005 as a result of the fair value adjustment to property, plant and equipment of \$6.1 million at the time of the 2005 Acquisition. The amortization of definite-life intangible assets of \$11.9 million in fiscal 2005 increased by \$4.4 million compared to \$7.5 million of amortization in fiscal 2004 as a result of the fair value adjustment to definite-life intangible assets of \$191.2 million at the time of the 2005 Acquisition.

Realized foreign exchange (gain) loss

Foreign currency fluctuations can represent a significant component of the variations in the Company's reported results from one period to the next. In fiscal 2005, as a result of generating net cash inflow of an appreciating Canadian dollar, the Company recognized a net realized gain of \$0.8 million due to these fluctuations compared with a \$2.7 million net realized loss in fiscal 2004.

Earnings from operations

The consolidated earnings from operations for fiscal 2005 in the amount of \$29.0 million (4.9% of revenue) decreased 40.5% compared to earnings from operations in fiscal 2004 of \$48.7 million (7.9% of revenue).

The earnings from bus manufacturing operations for fiscal 2005 were \$52.9 million compared to fiscal 2004 earnings of \$59.2 million (9.8% and 10.3%, respectively, of bus manufacturing revenue). This reduction in earnings is attributed primarily to the charge in fiscal 2005 related to the fair value adjustment to inventory at the time of the 2005 Acquisition and to higher amortization charges in fiscal 2005.

The earnings from aftermarket operations of \$10.3 million (19.3% of aftermarket revenue) in fiscal 2005 increased by 16.8% compared to fiscal 2004 earnings of \$8.8 million (20.0% of aftermarket revenue). This increase is attributed to higher sales volumes, as gross profit and operating costs, as a percentage of revenue, were consistent between these two periods.

The consolidated earnings from operations in fiscal 2005 have been impacted unfavorably by the increase of \$13.8 million in the unallocated costs compared to fiscal 2004. This increase consists primarily of the charges related to the termination of a management agreement and a transaction fee payable to Harvest Partner, Inc. and Lightyear Capital LLC and the settlement of management's options, incurred as a result of the 2005 Acquisition.

Unrealized foreign exchange (gain) loss

Unrealized foreign currency gains or losses arise from the revaluation of the Canadian dollar-denominated long-term debt and forward foreign exchange contracts. In fiscal 2005 the Company recognized a net unrealized loss of \$4.7 million compared to a net unrealized loss of \$0.2 million in fiscal 2004, consisting of the following:

	<u>Fiscal 2005</u>	<u>Fiscal 2004</u>
	(US dollars in thousands)	
Revaluation of Canadian dollar-denominated long-term debt.....	\$ 4,942	\$ 137
Unrealized (gain) loss on forward foreign exchanges contracts....	<u>(218)</u>	<u>77</u>
	<u>\$ 4,724</u>	<u>\$ 214</u>

The unrealized loss in fiscal 2005 primarily relates to the Canadian dollar denominated subordinated notes of NFI ULC forming part of the IDSs and separate subordinated notes of NFI ULC that mature in 2020.

Business disposition expenses

In fiscal 2005, the Company recorded \$1.8 million in business disposition expenses related to the 2005 Acquisition. As these costs were non-recurring and outside of the normal operating costs of the Company, they have been recorded outside earnings from operations. The business disposition expenses of \$13.4 million recorded in fiscal 2004 relate to the 2004 Acquisition.

Earnings before interest and taxes and other items (EBIT)

In fiscal 2005 the Company recorded earnings before interest and taxes of \$39.0 million compared to an EBIT of \$35.0 million in 2004. Earnings before interest and income taxes have been impacted by non-recurring charges and non-cash items as follows:

	<u>Fiscal 2005</u>	<u>Fiscal 2004</u>
Non-recurring charges:	(US dollars in thousands)	
Fair value adjustment to inventory	\$ 9,311	\$ 6,313
Business disposition expenses	1,758	13,395
Management and transaction fees	9,315	1,506
Stock-based compensation	<u>8,726</u>	<u>2,617</u>
Total non-recurring charges:.....	<u>29,110</u>	<u>23,831</u>
Non-cash charges (recovery):		
Fair value adjustment to other liabilities, Class B and Class C shares .	(16,637)	—
Unrealized foreign exchange loss.....	4,724	214
Amortization	<u>16,999</u>	<u>12,354</u>
Total non-cash charges:	<u>5,086</u>	<u>12,568</u>
	<u>\$ 34,196</u>	<u>\$ 36,399</u>

The fiscal 2005 earnings before interest and taxes include the non-recurring charges related to the fair market value adjustment to inventory of \$9.3 million and business disposition expenses resulting from the 2005 Acquisition of \$1.8 million. Similarly, the 2004 Acquisition resulted in charges related to the fair market value adjustment to inventory and business disposition expenses of \$6.3 million and \$13.4 million, respectively. Additionally, the fiscal 2005 and fiscal 2004 results have been impacted by stock-based compensations of \$8.7 million and \$2.6 million, respectively, and management and transaction fees of \$9.3 million and \$1.5 million, respectively. Both the stock-based compensation and the management and transaction fees ceased after the 2005 Acquisition.

A fair value adjustment to other liabilities, Class B and Class C common shares, was recorded and resulted in a recovery of \$16.7million, representing a reduction in value of Class B and Class C common shares of \$1.3 million and \$15.4 million, respectively. This adjustment reflects the current fair market value of

the Class B and Class C common shares calculated in accordance with the provisions of the securityholders agreement governing NFL Holdings. The unrealized foreign exchange loss in fiscal 2005 was \$4.7 million compared to \$0.2 million in fiscal 2004. Amortization charges increased by \$4.6 million in fiscal 2005 compared to fiscal 2004.

Absent these non-recurring charges and increases in non-cash charges, fiscal 2005 EBIT would have been \$73.2 million (or 12.4% of revenue) compared to \$71.4 million (or 11.6% of revenue) in fiscal 2004.

Interest expense (including distributions on Class B and C common shares)

The interest expense for fiscal 2005 totaled \$38.6 million compared to \$14.9 million in fiscal 2004. The difference in interest expense is due to the change in the Company's capital structure as a result of the 2005 Acquisition and 2004 Acquisition, including the issuance of Class B and Class C common shares and the related distributions.

Earnings before income taxes (EBT)

Earnings before income taxes for fiscal 2005 were \$0.4 million compared to EBT of \$20.1 million in 2004. The reduction in earnings between years is a result of the non-recurring costs, non-cash charges and increased interest costs as described above.

Income taxes

The income tax expense for fiscal 2005 was \$14.3 million, which was primarily due to the one-time impact of the 2005 Acquisition over and above the Company's statutory rate of 37.8%. The Company recorded income tax expenses of \$11.2 million in fiscal 2004, which represents an effective tax rate of 56.3%. The combined statutory rate for fiscal 2004 was 37.0%; however, there were substantial non-deductible costs associated with the 2004 Acquisition, which increased the effective tax rate.

Net earnings (loss)

The Company recorded a net loss of \$13.9 million for fiscal 2005 compared to net earnings of \$8.9 million during fiscal 2004.

Liquidity and Capital Resources

The Company's current liquidity requirements have been met with a revolving credit facility and cash. The Company has a \$40.0 million revolving credit facility, which is undrawn as at January 1, 2006. As of January 1, 2006, the Company had cash of \$21.4 million resulting in total liquidity of \$61.4 million.

As a result of the contract solicitation process in the bus manufacturing industry, bus purchase contracts are customer-specific and contain varied terms and conditions, including terms relating to the timing of payments made under such contracts. As such, the Company's accounts receivable are not always consistent or predictable, which may result in the Company drawing on its revolving credit facility in order to meet its working capital requirements.

Commitments and Contractual Obligations

Commitments

New Flyer's commitments and contractual obligations, as at January 1, 2006, principally include obligations associated with outstanding indebtedness, lease obligations, and guarantees under certain contracts.

	<u>Total</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>Post 2010</u>
	(\$US in thousands)						
Senior term loan	\$ 90,000	\$ —	\$ —	\$ —	\$ 90,000	\$ —	\$ —
Subordinated Notes included in IDS issue	95,099	—	—	—	—	—	95,099
Separate Subordinated Notes	28,633	—	—	—	—	—	28,633
Capital leases	4,176	985	809	682	507	488	705
Operating leases	<u>37,104</u>	<u>2,426</u>	<u>1,998</u>	<u>2,034</u>	<u>2,071</u>	<u>1,733</u>	<u>26,842</u>
	<u>\$255,012</u>	<u>\$3,411</u>	<u>\$ 2,807</u>	<u>\$ 2,716</u>	<u>\$ 92,578</u>	<u>\$ 2,221</u>	<u>\$151,279</u>

The senior credit facility (consisting of a secured revolving credit facility of up to \$40 million, a letter of credit facility of up to \$50 million and a \$90 million secured term loan facility (the "New Credit Facility")), subordinated notes of NFI ULC forming part of the IDSs, and the separate subordinated notes of NFI ULC contain certain restrictive covenants, the more significant of which relate to a fixed charge ratio, debt ratios, and capital expenditures. If the Company fails to meet these or any other restrictive covenants, the Company's creditors could accelerate the loans, thereby making all amounts owed immediately due and payable.

Contractual Guarantees

Through the normal course of operations, the Company has indemnified the surety companies providing surety bonds required under various contracts with customers. In the event that the Company fails to perform under a customer contract and the surety companies incur a cost on a surety bond, the Company is obligated to repay the costs incurred in relation to the claim up to the value of the bond. The Company's guarantee under each bond issued by the surety companies expires on completion of obligations under the customer contract to which the bond relates. To management's knowledge, the Company has never had a surety bond drawn. The estimated maturity dates of the surety bonds outstanding at January 1, 2006 range from November 2006 to January 2008. At January 1, 2006, outstanding surety bonds guaranteed by the Company amounted to \$35.0 million. The Company has not recorded a liability under these guarantees as management believes that no material events of default exist under any contracts with customers.

Under the senior credit facility, the Company has established a letter of credit facility of \$50 million. As at January 1, 2006, letters of credit amounting to \$11.5 million remain outstanding under the letter of credit facility as security for the following contractual obligations of the Company:

	<u>(US dollars in thousands)</u>	
Collateral to secure operating facility leases	\$	523
Collateral to secure surety facilities		8,958
Collateral to secure customer performance guarantees		656
Collateral in support of self-insured workers' compensation obligations		1,381

As at January 1, 2006, management believes that the Company is in compliance in all material respects with all applicable contractual obligations and management has not provided for any costs associated with these letters of credit.

Cash Flow

The cash flows of the Company are summarized as follows:

	Fiscal <u>2005</u> (unaudited) (US dollars in thousands)	Fiscal <u>2004</u> (unaudited)
Cash (outflow) inflow from operating activities	\$ (10,255)	\$ 23,744
Cash inflow from financing activities	82,267	232,051
Cash outflow from investing activities	(53,181)	(251,191)

Cash flows from operating activities

The fiscal 2005 net operating cash outflow of \$10.3 million is primarily the result of net cash losses before working capital changes of \$22.2 million and a payment of \$9.1 million of withholding taxes related to the period prior to the 2005 Acquisition, offset by a reduction in working capital investment of \$21.0 million. The net cash operating inflow in fiscal 2004 of \$23.7 million resulted from net cash earnings before working capital of \$18.8 million and a reduction in working capital investment of \$4.9 million. The reduction in cash income between years is primarily due to increased cash interest and income taxes resulting from the 2005 Acquisition.

Cash flow from financing activities

The financing activities provided net cash inflow of \$82.3 million in fiscal 2005 compared to \$232.1 million in fiscal 2004.

The 2005 Acquisition provided \$113.6 million of cash as follows:

1. The Company issued shares to capitalize the Company with \$66.3 million;
2. The Company issued debt of \$208.8 million and incurred debt issuance costs of \$13.9 million providing net cash inflow of \$194.9 million; and
3. Existing debt in the amount of \$147.6 million was repaid.

Excluding the cash inflow related to the 2005 Acquisition, financing activities resulted in a cash outflow for the fiscal 2005 of \$31.3 million, which consisted of repayments of capital lease obligations of \$4.2 million (including the exercise of the purchase option on the Crookston facility), repayments of senior debt prior to the 2005 Acquisition of \$25.4 million and dividend payments of \$1.7 million to NFI and the Existing Investors.

In 2004, the cash inflow from financing activities of \$232.1 million resulted from \$282.7 million from the 2004 Acquisition less \$49.0 million in repayments of senior debt and a \$1.1 million repayment of

capital lease obligations. In addition, the Company incurred costs in the amount of \$0.5 million to amend the credit agreement to reduce the senior borrowing rate by 0.75%.

Cash flow from investing activities

Fiscal 2005 investing activities resulted in a net cash outflow of \$53.2 million consisting primarily of \$51.1 million related to the 2005 Acquisition and \$2.3 million for property, plant and equipment acquisitions. In fiscal 2004, the cash outflow from investing activities was \$251.2 million. Of this amount, \$265.9 million related to the 2004 Acquisition. The remaining cash inflow of \$14.7 million consisted of the proceeds from the sale and leaseback of the St. Cloud manufacturing plant and capital expenditures in the normal course of operations.

Financial Instruments and Other Instruments

The Company's financial instruments consist of cash, accounts receivable, deposits, accounts payable and accrued liabilities, obligations under capital lease, long-term debt and other liabilities, Class B and Class C common shares. The carrying value of cash, accounts receivable, deposits, accounts payable and accrued liabilities approximates their fair value due to the short-term maturities of these instruments. The carrying amount of obligations under capital leases approximates fair value. The carrying value of the senior term loan approximates fair value because the interest rate is variable. All other debt of the Company bears interest at fixed rates, and the fair values as at January 1, 2006 have been estimated based on future projected cash flows as follows:

	<u>Carrying Amount</u>	<u>Fair Value</u>
	(US dollars in thousands)	
Subordinated Notes forming part of IDSs.....	\$ 95,099	\$ 95,389
Separate Subordinated Notes.....	28,633	28,720

The Company is exposed to interest rate risk with respect to adverse changes in the LIBOR rate on the senior term loan. As at January 1, 2006, the Company has a cross-currency interest rate swap maturing in 2009 with a notional principal amount of C\$108.0 million bearing interest at 7.13% to manage this risk. The changes in fair value of the interest rate swap, net of settlement costs, were recorded in the fair value of the cross-currency interest rate swap caption in the statement of operations for fiscal 2005 in the amount of \$0.7 million. The fair value of the cross-currency interest rate swap has been recorded on the consolidated balance sheet in the item "derivative financial instruments liability" in the amount of \$0.1 million as at January 1, 2006.

The Company is exposed to foreign exchange risk on accounts receivable, accounts payable and accrued liabilities and obligations under capital lease denominated in Canadian dollars. The Company does not hold financial instruments for speculative or trading purposes and has not elected to apply hedge accounting to its derivative financial instruments.

The Company's financial instruments exposed to credit risk include cash, accounts receivable, and derivatives. The Company places its cash with commercial institutions of high creditworthiness. Accounts receivable primarily comprise amounts due from large, well-established transit authorities in the United States and Canada, and as such, management believes that the Company's accounts receivable credit risk exposure is limited. Additionally, the U.S. federal government funds a substantial portion of the U.S. customer receivables. The counterparties to the Company's derivatives are significant financial institutions. The Company could be exposed to losses in the event of non-performance by the counter party. However, credit

ratings and concentration of risk of the financial institutions are monitored on an ongoing basis. Management believes the credit risk exposure is limited.

Critical Accounting Estimates

A summary of significant accounting policies is included in note 2 to the Company's consolidated financial statements for the period ended January 1, 2006. Critical accounting estimates require management to make certain judgments and estimates, some of which may be uncertain. Changes in these accounting estimates may have an impact on the financial results of the Company. Details of the critical accounting estimates are discussed below.

The Company values its inventory on a first-in, first-out basis at the lower of cost and net realizable value. The process for determining the appropriate inventory obsolescence provision requires management to take into consideration factors such as inventory aging, planned consumption of raw materials in the near term, and the future demand for the inventory. A change in these assumptions could impact the valuation of inventory and have an impact on operating costs and expenses and net earnings.

The Company records an allowance for doubtful accounts related to accounts receivable that may be potentially impaired. The allowance is based on the Company's knowledge of the financial condition of its customers, the aging of the receivables, current business environment and historical experience. A change to these factors could impact the estimated allowance and the provision for bad debt expense recorded in operating costs and expenses.

Goodwill and intangible assets having an indefinite life are not amortized but are tested for impairment, at least annually. Management applies a fair-value-based test to the carrying value of indefinite-life intangible assets and goodwill. A goodwill or intangible asset impairment charge would be recorded if the amount of the carrying value of goodwill or indefinite-life intangible assets exceeds the fair value of the respective assets.

The Company also carries intangible assets that are comprised of patents and customer relationships that have definite lives. These intangibles are amortized over their estimated useful lives of 13 to 17 years. Management judgment is required to determine the useful life of the intangible assets and, where it is believed to be required, an impairment provision is provided if the carrying amount of the asset is not recoverable and exceeds its fair value. The useful life of between 13 and 17 years is determined by reviewing the term of the patents and the history of the customer relationship.

Products sold as part of the bus manufacturing and aftermarket segments are accompanied by warranties for equipment, parts and service. Warranty cost is recorded when revenue for the underlying product is recognized. The cost is estimated based on a number of factors, including the historical warranty claims and cost experience by customer, the type and duration of warranty coverage and the nature of products sold. The Company reviews quarterly its recorded product warranty provisions and any adjustments are recognized to earnings. Warranty expense is recorded as a component of operating costs and expenses.

The accrued benefit liability for the Company's defined benefit pension plan is determined based on a number of assumptions, such as expected return on assets and discount rates. The Company manages the underlying defined benefit pension plan by meeting with the actuarial consultants and the fund manager on a regular basis and reviewing periodic reports outlining the return on pension assets relative to the market and assessing the sufficiency of those assets relative to the actuarially determined liabilities of the plan. The Company ensures that certain assumptions provided by the actuarial consultant, such as expected return on pension assets, are consistent with the market in general. Assumptions are reviewed on an on-going basis and adjustments are made whenever management feels that conditions have materially changed.

The Company follows the asset and liability method of accounting for income taxes. Future income tax assets are recognized only to the extent that management determines it is more likely than not that the future income tax assets will be realized. At January 1, 2006, the Company had approximately \$0.9 million in non-capital losses carried forward in the U.S. available to reduce taxable income in future years. The Company has not recorded a valuation against the future tax asset associated with these losses carried forward or other future tax assets. Any changes in management's assessment of the likelihood of realizing the future tax asset will directly impact future income tax expense and therefore net earnings.

The Company is involved in legal proceedings and other claims arising in the normal course of business. Management believes that the Company maintains an appropriate level of insurance coverage. Management must use judgment to determine whether or not a claim has any merit, the estimated amount of the claim and whether to record a provision, which is dependent on the potential success of the claim. Management does not believe that any liability that may arise from the current claims will have a material adverse impact on the financial condition of the Company.

Recent Changes in Accounting Standards and Policies

Impairment of Long-lived Assets

Effective January 1, 2004, the Company adopted the provisions of CICA Handbook Section 3063, "Impairment of Long-lived Assets". Under this Section, long-lived assets are tested for impairment when events or circumstances indicate that they are not recoverable, by comparing the estimate of future undiscounted cash flows to the carrying amount of the assets or group of assets. The Company reviews the recoverability of long-lived assets at least annually or whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. The Company did not record any impairment loss as a result of the adoption of the new standard.

Asset Retirement Obligations

Effective January 1, 2004, the Company adopted the provisions of CICA Handbook Section 3110, "Asset Retirement Obligations". The standard provides guidance for the recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement cost. The standard applies to legal obligations associated with the retirement of a tangible long-lived asset and applies to obligations for both lessors and lessees in connection with leased assets. Under the standard, the fair value of liabilities for asset retirement obligations is recognized in the period they are incurred. A corresponding increase to the carrying amount of the related asset is recorded and amortized over the life of the asset. The obligations are accreted to full value over time through charges to income. The Company has determined that there is an immaterial impact on its consolidated financial statements as a result of adopting this standard.

Future Changes to Accounting Standards

The following recently issued accounting pronouncements represent a summary of the pronouncements that are likely to, or may at some future time, have an impact on the Company.

Financial Instruments — Recognition and Measurement, Handbook Section 3855

Section 3855 prescribes when a financial asset, financial liability or non-financial derivative is to be recognized on the balance sheet and at what amount, in certain instances using fair value and in others using cost-based measures. It also specifies how financial instrument gains and losses are to be presented.

Section 3855 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Earlier adoption is permitted only as of the beginning of a fiscal year ending on or after December 31, 2004. The Company plans to adopt this standard for its 2007 fiscal year or earlier. Transitional provisions for this Section are complex and vary based on the type of financial instrument under consideration. The Company is currently evaluating the impact of adopting this standard.

Comprehensive Income, Handbook Section 1530

Section 1530 introduces a new requirement to temporarily present certain gains and losses outside net income. Section 1530 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Earlier adoption is permitted only as of the beginning of a fiscal year ending on or after December 31, 2004. The Company plans to adopt this standard for its 2007 fiscal year or earlier. Financial statements of prior periods are required to be restated for certain comprehensive income items. In addition, an enterprise is encouraged, but not required, to present reclassification adjustments in comparative financial statements provided for earlier periods. The Company is currently evaluating the impact of adopting this standard.

Hedges, Handbook Section 3865

Section 3865 establishes standards for when and how hedge accounting may be applied. Hedge accounting is optional. This Section applies for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Retroactive application is not permitted. Earlier adoption is permitted only as of the beginning of a fiscal year that ends on or after December 31, 2004. The Company is currently evaluating the impact of adopting this standard.

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures designed to ensure that the information required to be disclosed in reports filed or submitted under applicable securities legislation is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

In accordance with Multilateral Instrument 52-109, "Certification of Disclosure in Issuers' Annual and Interim Filings", management carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, except for a weakness in controls over the analysis and reporting of the Company's income tax provision, the Company's disclosure controls and procedures were effective as of January 1, 2006 to provide reasonable assurance that information required to be disclosed is recorded, processed, summarized, and reported within the time periods specified by applicable securities legislation. Management is committed to improving its processes to address the weakness referred to above which related primarily to the complexity of the Company's new capital structure. Errors in the income tax provision resulting from this weakness which were identified in the course of the year end audit have been corrected so that the income tax provision is fairly stated in the financial statements.

Unaudited Combined 2005 Financial Information

Combined Statement of Operations for the 52-Weeks Ended January 1, 2006

The combined statement of operations for the 52-week period ended January 1, 2006 has been prepared from the audited consolidated statement of operations of the Company for the 19-week period ended January 1, 2006 and from the audited consolidated statement of operations of THI for the 33-week period ended August 18, 2005.

	NFL Holdings 19-Weeks Ended <u>January 1, 2006</u>	THI 33-Weeks Ended <u>August 18, 2005</u>	Fiscal <u>2005</u> (unaudited)
	(US dollars in thousands)		
Revenue	\$ 208,948	\$ 381,856	\$ 590,804
Operating costs and expenses	193,926	351,689	545,615
Amortization	8,630	8,369	16,999
Foreign exchange gain	<u>(495)</u>	<u>(331)</u>	<u>(826)</u>
Earnings from operations	6,887	22,129	29,016
Unrealized foreign exchange loss (gain) on non-current monetary items and forward foreign exchange contracts	4,826	(102)	4,724
Fair value adjustment to other liabilities, Class B and Class C common Shares	(16,637)	—	(16,637)
Loss (gain) on disposition of property, plant and equipment	159	(16)	143
Business disposition expenses	<u>—</u>	<u>1,758</u>	<u>1,758</u>
Earnings before interest and income taxes	18,539	20,489	39,028
Interest expense, including distribution on Class B and Class C common shares	<u>17,844</u>	<u>20,774</u>	<u>38,618</u>
Earnings (loss) before income taxes	695	(285)	410
Income taxes (recovery)	<u>(10,383)</u>	<u>24,644</u>	<u>14,261</u>
Net earnings (loss)	<u>\$ 11,078</u>	<u>\$ (24,929)</u>	<u>\$ (13,851)</u>

Combined Statement of Cash Flows for the 52-Weeks Ended January 1, 2006

The combined statement of cash flows for the 52-week period ended January 1, 2006 has been prepared from the audited consolidated statement of cash flows of the Company for the 19-week period ended January 1, 2006 and from the audited consolidated statement of cash flows of THI for the 33-week period ended August 18, 2005.

	NFL Holdings 19-Weeks Ended <u>January 1, 2006</u>	THI 33-Weeks Ended <u>August 18, 2005</u>	Fiscal <u>2005</u> (unaudited)
	(US dollar in thousands)		
Operating activities			
Net earnings (loss)	\$ 11,078	\$ (24,929)	\$ (13,851)
Items not affecting cash	(16,150)	9,156	(6,994)
Defined benefit funding	<u>(539)</u>	<u>(803)</u>	<u>(1,342)</u>
	(5,611)	(16,576)	(22,187)
Withholding taxes paid	(9,111)	—	(9,111)
Changes in non-cash working capital items	<u>(25,395)</u>	<u>46,438</u>	<u>21,043</u>
Operating cash flows.....	(40,117)	29,862	(10,255)
Financing activities	113,274	(31,007)	82,267
Investing activities.....	<u>(51,780)</u>	<u>(1,401)</u>	<u>(53,181)</u>
Net cash inflow (outflow)	\$ <u>21,377</u>	\$ <u>(2,546)</u>	\$ <u>18,831</u>

Unaudited Combined 2004 Financial Information

Combined Statement of Operations for the 53-Weeks Ended January 2, 2005

The combined statement of operations for the 53-week period ended January 2, 2005 has been prepared from the audited consolidated statement of operations of THI for the 44-week period ended January 2, 2005 and from the audited consolidated statement of operations of NFIL Holdings Corp. for the 9-week period ended February 27, 2004.

	<u>44-Weeks Ended</u> <u>January 2, 2005</u>	<u>9-Weeks Ended</u> <u>February 27, 2004</u>	<u>Fiscal</u> <u>2004</u> (unaudited)
	(US dollars in thousands)		
Revenue	\$ 530,094	\$ 86,897	\$ 616,991
Operating costs and expenses	474,335	78,892	553,227
Amortization	11,577	777	12,354
Foreign exchange loss (gain)	<u>2,939</u>	<u>(267)</u>	<u>2,672</u>
Earnings from operations	41,243	7,495	48,738
Loss (gain) on disposition of property, plant and equipment	116	—	116
Unrealized foreign exchange loss (gain) on non-current monetary items and forward foreign exchange contracts	165	49	214
Business disposition expenses	<u>656</u>	<u>12,739</u>	<u>13,395</u>
Earnings (loss) before interest and income taxes	40,306	(5,293)	35,013
Interest expense	<u>14,100</u>	<u>806</u>	<u>14,906</u>
Earnings (loss) before income taxes	26,206	(6,099)	20,107
Income taxes	<u>10,145</u>	<u>1,059</u>	<u>11,204</u>
Net earnings (loss)	<u>\$ 16,061</u>	<u>\$ (7,158)</u>	<u>\$ 8,903</u>

Combined Statement of Cash Flows for the 53-Weeks Ended January 2, 2005

The combined statement of cash flows for the 53-week period ended January 2, 2005 has been prepared from the audited consolidated statement of cash flows of THI for the 44-week period ended January 2, 2005 and from the audited consolidated statement of cash flows of NFIL Holdings Corp. for the 9-week period ended February 27, 2004.

	44-Weeks Ended <u>January 2, 2005</u>	9-Weeks Ended <u>February 27, 2004</u>	Fiscal <u>2004</u> (unaudited)
	(US dollars in thousands)		
Operating activities			
Net earnings (loss).....	\$ 16,061	\$ (7,158)	\$ 8,903
Items not affecting cash	9,019	1,904	10,923
Defined benefit funding	<u>(854)</u>	<u>(173)</u>	<u>(1,027)</u>
	24,226	(5,427)	18,799
Changes in non-cash working capital items	<u>8,060</u>	<u>(3,115)</u>	<u>4,945</u>
Operating cash flows.....	32,286	(8,542)	23,744
Financing activities	232,291	(240)	232,051
Investing activities.....	<u>(250,855)</u>	<u>(336)</u>	<u>(251,191)</u>
Net cash inflow (outflow).....	<u>\$ 13,722</u>	<u>\$ (9,118)</u>	<u>\$ 4,604</u>

Financial Statements of
NEW FLYER INDUSTRIES INC.
January 1, 2006

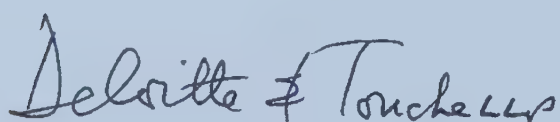
AUDITORS' REPORT

To the Shareholders
New Flyer Industries Inc.

We have examined the balance sheet of New Flyer Industries Inc. as at January 1, 2006 and the statements of operations and retained earnings and of cash flows for the 29-week period then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at January 1, 2006 and the results of its operations and its cash flows for the 29-week period then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants

Winnipeg, Manitoba
March 21, 2006

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NEW FLYER INDUSTRIES INC.

BALANCE SHEET

As at January 1, 2006

(in thousands of U.S. dollars except per share figures)

Assets

Current

Cash	\$ 143
Due from related parties (note 6)	36,927
Prepays.....	74
Investment in New Flyer Holdings, Inc. (note 3)	<u>75,235</u>
	<u>\$ 112,379</u>

Liabilities

Current

Due to related parties (note 6)	\$ 36,626
Dividends payable	<u>467</u>
	<u>37,093</u>

Shareholders' Equity

Share capital (note 4).....	66,320
Retained earnings	<u>8,966</u>
	<u>75,286</u>
	<u>\$ 112,379</u>

The accompanying notes are an integral part of the financial statements.

NEW FLYER INDUSTRIES INC.
STATEMENT OF OPERATIONS AND RETAINED EARNINGS
For the 29-week period from incorporation on June 16, 2005 to January 1, 2006
(in thousands of U.S. dollars except per share figures)

Income from equity accounted investment	\$ 11,078
Interest income	70
General and administrative expenses	(109)
Foreign exchange gain	<u>90</u>
Earnings before income taxes	11,129
Income tax expense (note 5)	<u>108</u>
Net earnings for the period.....	11,021
Retained earnings – beginning of period	—
Dividends declared	<u>(2,055)</u>
Retained earnings – end of period.....	<u>\$ 8,966</u>
Net earnings per share (basic and diluted)	<u>\$ 0.81</u>

The accompanying notes are an integral part of the financial statements.

NEW FLYER INDUSTRIES INC.

STATEMENT OF CASH FLOWS

For the 29-week period from incorporation on June 16, 2005 to January 1, 2006

(in thousands of U.S. dollars except per share figures)

Cash provided by (used in)

Operating activities

Net earnings for the period	\$ 11,021
Income from equity accounted investment	(11,078)
Changes in non-cash working capital balances	<u>116</u>
	<u>59</u>

Financing activities

Share issuance	73,787
Share issuance costs	(7,467)
Dividends paid	<u>(1,588)</u>
	<u>64,732</u>

Investing activities

Investment in New Flyer Holdings, Inc.	(66,320)
Dividends received from New Flyer Holdings, Inc.	<u>1,672</u>
	<u>(64,648)</u>

Increase in cash	143
Cash — beginning of period	<u>—</u>
Cash — end of period	<u>\$ 143</u>

The accompanying notes are an integral part of the financial statements.

NEW FLYER INDUSTRIES INC.
NOTES TO FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

1. BASIS OF PRESENTATION

New Flyer Industries Inc. ("NFI" or the "Company") was incorporated on June 16, 2005 under the laws of the Province of Ontario. New Flyer Industries Canada ULC ("NFI ULC" and together with NFI, the "Issuer") was incorporated on June 22, 2005 as an unlimited liability corporation pursuant to the laws of the Province of Alberta. The Issuer, pursuant to an underwriting agreement dated August 12, 2005, filed a prospectus dated August 12, 2005 (the "Prospectus") for an initial public offering (the "Offering") of income deposit securities ("IDSs") of the Issuer. The Offering was completed on August 19, 2005. Each IDS consists of one common share ("Common Share") of NFI and C\$5.53 principal amount of 14% subordinated notes ("Subordinated Notes") of NFI ULC. In connection with the Offering, NFI ULC also issued, on a private placement basis, C\$33,300 aggregate principal amount of separate subordinated notes ("Separate Subordinated Notes"). The Issuer used the net proceeds of the Offering and the private placement of Separate Subordinated Notes to acquire 100% of the Class A common shares ("Class A Shares") of New Flyer Holdings, Inc. ("NFL Holdings") and for other transactions described in the Prospectus. NFL Holdings is a company incorporated on June 21, 2005 under the laws of the State of Delaware. NFL Holdings, in turn, acquired a 100% interest in Transit Holdings, Inc. ("THI") and its subsidiaries through (i) NFL Holdings acquiring the majority of the outstanding shares and warrants of THI (ii) THI purchasing for cancellation a portion of the existing THI options and (iii) New Flyer Transit L.P. (the "Continuing Investor") exchanging its remaining shares and warrants of THI upon expiry of the over-allotment option into shares of NFL Holdings. THI subsidiaries include NFI ULC, New Flyer of America Inc. ("NFAI") and 1176846 Alberta ULC ("AB ULC").

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements of NFI are prepared in accordance with generally accepted accounting principles in Canada and are presented in U.S. dollars, representing the functional currency of the Company. The following is a summary of significant accounting policies of the Company:

Fiscal period

NFI's fiscal year is based on four 13-week quarters, which are consistent with the period ends of NFL Holdings, as follows:

<u>Quarter</u>	<u>Period End Date</u>	<u>Weeks in the Period</u>
Quarter 1	—	—
Quarter 2	July 3, 2005	3
Quarter 3	October 2, 2005	13
Quarter 4	January 1, 2006	13
		29

NEW FLYER INDUSTRIES INC.
NOTES TO FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Investment in New Flyer Holdings, Inc.

The Company's investment in NFL Holdings, as described in note 1, has been determined to be an investment in a variable interest entity (VIE) under Canadian Institute of Chartered Accountants Guideline No. 15 "Consolidation of Variable Interest Entities" (AcG-15). Through its ownership of the Class A Shares, NFI holds a 51% voting interest and a 36.9% economic interest in NFL Holdings. As NFI does not hold the majority economic interest in NFL Holdings, NFI is not the primary beneficiary (as that term is defined in AcG-15) of the VIE, and therefore, NFL Holdings is not consolidated by NFI. As a result, NFI accounts for its investment in NFL Holdings using the equity method of accounting whereby the investment is initially recorded at cost and the carrying amount adjusted thereafter by NFI's 100% share of post acquisition earnings of NFL Holdings, which include deductions for distributions on the Class B common shares and the Class C common shares of NFL Holdings held by the Continuing Investor and New Flyer LLC. Dividends received or receivable from NFL Holdings reduce the carrying value of the investment.

Foreign currencies

Amounts denominated in a foreign currency are translated to U.S. dollars as follows:

- Monetary balances, including cash, due to related parties and dividends payable, at the period end exchange rate.
- Non-monetary balances, including the investment in NFL Holdings, at the exchange rate prevailing at the date of transaction.
- Exchange gains or losses on translation of foreign currencies are included in net earnings.

Income taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are recognized for temporary differences between the accounting and tax bases of the Company's assets and liabilities, and are measured using substantively enacted tax rates that are expected to be in effect when the differences are settled. The effect of the changes in income tax rates is recognized in the year in which the rate change is considered substantively enacted. The income tax provision represents income taxes paid or payable for the current year plus the change in the future income taxes during the year. A valuation allowance is provided against future income tax assets when it is more likely than not that all or some portion of the future income tax assets will not be realized.

3. INVESTMENT IN NEW FLYER HOLDINGS, INC.

Investment in Class A Shares.....	\$ 66,320
Income from equity investment for the period	11,078
Dividends.....	(2,163)
	<u>\$ 75,235</u>

NEW FLYER INDUSTRIES INC.
NOTES TO FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

4. SHARE CAPITAL

Authorized		
Unlimited	Common Shares	
Issued		
20,000,000	Common Shares	<u>\$ 66,320</u>

The Company issued one common share for nominal cash consideration on June 16, 2005. On August 19, 2005 this share was repurchased for cancellation at the amount issued.

On August 19, 2005, the Company issued 20,000,000 common shares for cash consideration of \$73,787. Share issuance costs of \$7,467 were incurred and charged to share capital.

The weighted average number of shares outstanding for the period that was used in the calculation of basic and fully diluted earnings per share is 13,600,000.

During the period from June 16, 2005 to January 1, 2006, the Company declared dividends of \$2,055 to the holders of Common Shares.

5. INCOME TAXES

The reconciliation of income tax attributable to continuing operations, calculated at the statutory rates, to income tax expense is as follows:

Earnings before income taxes.....	\$ 11,129
Combined statutory rate.....	<u>36.1%</u>
	4,018
Non-taxable income from equity accounted investment.....	(3,999)
Benefit of deductible share issue costs.....	(198)
Valuation allowance.....	179
Withholding tax on dividends from NFL Holdings.....	<u>108</u>
	<u>\$ 108</u>

NEW FLYER INDUSTRIES INC.
NOTES TO FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

5. INCOME TAXES (continued)

The Company has a loss carry-forward of \$499 generated during the 29-week period ended January 1, 2006, which may be applied against future taxable income. The right to claim this loss expires in 2011. In addition, for tax purposes, the Company has undeducted share issuance costs in the amount of \$6,925. The loss carry-forward and the undeducted share issuance costs resulted in a future income tax asset of \$2,682. Annually, the Company reviews the likelihood of realization of the future benefits of the loss carry-forwards. In management's opinion the criteria for recording a future tax asset has not been met. Therefore, the future tax asset resulting from the temporary differences and loss carry-forward has not been recognized in the financial statements.

6. RELATED PARTY TRANSACTIONS

The following related party balances occurred as a result of the August 19, 2005 acquisition transactions:

Due from related parties:	
New Flyer Industries Canada ULC.....	\$ 24,503
New Flyer of America Inc.....	<u>12,424</u>
	<u>36,927</u>
Due to related parties:	
New Flyer Holdings, Inc.....	78
Transit Holdings, Inc.....	<u>36,548</u>
	<u>36,626</u>
	<u>\$ 301</u>

All related party balances are non-interest bearing and have no terms of repayment.

7. GUARANTEES

The Company indemnifies its directors and officers against claims and damages that may be incurred in the performance of their services to the Company. Liability insurance has been purchased with respect to the Company's directors and officers.

Consolidated Financial Statements of
NEW FLYER HOLDINGS, INC.
January 1, 2006

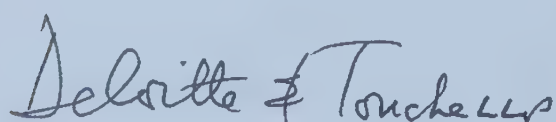
AUDITORS' REPORT

To the Shareholders
New Flyer Holdings, Inc.

We have examined the consolidated balance sheet of New Flyer Holdings Inc. as at January 1, 2006 and the consolidated statements of operations and retained earnings and of cash flows for the 19-week period then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at January 1, 2006 and the results of its operations and its cash flows for the 19-week period then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants

Winnipeg, Manitoba
March 21, 2006

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NEW FLYER HOLDINGS, INC.
CONSOLIDATED BALANCE SHEET

As at January 1, 2006
(in thousands of U.S. dollars except per share figures)

Assets

Current

Cash and cash equivalents.....	\$ 21,377
Accounts receivable (note 4).....	47,520
Inventories (note 5)	73,021
Prepaid expenses and deposits	8,117
Future income tax assets (note 14).....	<u>11,812</u>
	161,847

Property, plant and equipment (note 6).....	32,269
Deferred charges (note 7).....	13,442
Intangible assets (note 8).....	383,699
Future income tax assets (note 14).....	33,332
Goodwill (note 3).....	<u>201,083</u>
	<u>\$ 825,672</u>

Liabilities

Current

Accounts payable and accrued liabilities	\$ 89,743
Due to parent company (note 17).....	301
Deferred revenue	17,922
Provision for warranty costs.....	19,158
Current portion of obligations under capital lease (note 9).....	<u>810</u>
	127,934

Accrued benefit liability (note 18).....	3,201
Obligations under capital lease (note 9).....	2,820
Future income tax liabilities (note 14).....	141,951
Long-term debt (note 10)	213,732
Derivative financial instruments (note 15).....	149
Other liabilities, Class B and Class C common shares (note 11).....	<u>260,650</u>
	<u>750,437</u>

Commitments and contingencies (note 19)

Shareholders' equity

Share capital (note 12).....	66,320
Retained earnings	<u>8,915</u>
	<u>75,235</u>
	<u>\$ 825,672</u>

The accompanying notes are an integral part of the consolidated financial statements.

NEW FLYER HOLDINGS, INC.

CONSOLIDATED STATEMENT OF OPERATIONS AND RETAINED EARNINGS

19-week period from commencement of operations on August 19, 2005 to January 1, 2006

(in thousands of U.S. dollars except per share figures)

Revenue.....	\$ 208,948
Operating costs and expenses.....	193,926
Amortization	8,630
Foreign exchange gain	(495)
Earnings from operations.....	6,887
Unrealized foreign exchange loss on non-current monetary items and forward foreign exchange contracts.....	4,826
Fair value adjustment to other liabilities, Class B and C common shares (note 11)	(16,637)
Loss on disposition of property, plant and equipment.....	<u>159</u>
Earnings before interest and income taxes.....	18,539
Interest expense	
Interest on long-term debt.....	8,562
Amortization of deferred charges.....	480
Other interest and bank charges.....	100
Fair market value adjustment on cross-currency interest rate swap (note 15)	<u>114</u>
	9,256
Distributions on Class B and Class C common shares (note 11).....	<u>8,588</u>
	<u>17,844</u>
Earnings before income tax expense	695
Income tax expense (recovery) (note 14)	
Current income taxes	3,400
Future income taxes (recovery)	<u>(13,783)</u>
	<u>(10,383)</u>
Net earnings for the period.....	11,078
Retained earnings — Beginning of period	—
Dividends declared (note 12)	<u>(2,163)</u>
Retained earnings — End of period.....	<u>\$ 8,915</u>

The accompanying notes are an integral part of the consolidated financial statements.

NEW FLYER HOLDINGS, INC.

CONSOLIDATED STATEMENT OF CASH FLOWS

19-week period from commencement of operations on August 19, 2005 to January 1, 2006

(in thousands of U.S. dollars except per share figures)

Cash provided by (used in)

Operating activities

Net earnings for the period.....	\$ 11,078
Amortization of plant and equipment	2,429
Amortization of intangible assets.....	6,201
Amortization of deferred charges.....	480
Loss on disposition of property, plant and equipment.....	159
Future income taxes recovery	(13,783)
Defined benefit expense (note 18)	317
Unrealized gain on derivatives.....	(142)
Unrealized foreign exchange loss on non-current monetary items and forward foreign exchange contracts.....	4,826
Fair value adjustment to other liabilities, Class B and C common shares (note 11).....	(16,637)
Defined benefit funding (note 18).....	<u>(539)</u>
Cash from operating activities before changes in non-cash working capital items	(5,611)
Withholding taxes paid.....	(9,111)
Changes in non-cash working capital items (note 13).....	<u>(25,395)</u>
	<u>(40,117)</u>

Financing activities

Proceeds from issue of long-term debt	208,769
Repayment of long-term debt.....	(147,632)
Repayment of obligations under capital lease	(169)
Deferred debt financing costs.....	(12,342)
Share issuance	66,320
Dividends paid	<u>(1,672)</u>
	<u>113,274</u>

Investing activities

Acquisition of property, plant and equipment	(861)
Net cash used in acquisition (note 3)	(51,098)
Proceeds on disposition of property, plant and equipment.....	<u>179</u>
	<u>(51,780)</u>

Increase in cash and cash equivalents.....	21,377
Cash and cash equivalents — beginning of period.....	<u>—</u>
Cash and cash equivalents — end of period.....	<u>\$ 21,377</u>

Supplemental disclosure of cash flow information

Cash payments of interest.....	\$ 11,954
Cash payments of income taxes	17,025

The accompanying notes are an integral part of the consolidated financial statements.

NEW FLYER HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

New Flyer Holdings, Inc. ("NFL Holdings" or the "Company") was incorporated on June 21, 2005 under the laws of the State of Delaware. The Company had no operations prior to the August 19, 2005 transaction described below.

These financial statements include the operations of the New Flyer business for the period from August 19, 2005 to January 1, 2006. New Flyer is the manufacturer of the New Flyer branded heavy-duty transit buses. The business also includes aftermarket parts and service including the sale of bus parts.

The consolidated financial statements are those of NFL Holdings together with its subsidiaries, Transit Holdings, Inc. ("THI"), New Flyer of America Inc. ("NFAI"), New Flyer Industries Canada ULC ("NFI ULC") and 1176846 Alberta ULC ("AB ULC").

August 19, 2005 transaction

New Flyer Industries Inc. ("NFI") was incorporated on June 16, 2005 under the laws of the Province of Ontario. NFI ULC (and together with NFI, the "Issuer") was incorporated on June 22, 2005 as an unlimited liability corporation pursuant to the laws of the Province of Alberta. The Issuer, pursuant to an underwriting agreement dated August 12, 2005, filed a prospectus on August 12, 2005 for an initial public offering (the "Offering") of 20,000,000 income deposit securities ("IDSs") of the Issuer. The Offering was completed on August 19, 2005. Each IDS consists of one common share ("Common Share") of NFI and C\$5.53 principal amount of 14% subordinated notes ("Subordinated Notes") of NFI ULC. In connection with the Offering, NFI ULC also issued, on a private placement basis, C\$33,300 aggregate principal amount of separate subordinated notes ("Separate Subordinated Notes"). The Separate Subordinated Notes are identical in all respects to the Subordinated Notes represented by the IDSs, and were issued under the same indenture. Accordingly, holders of the Separate Subordinated Notes and holders of the Subordinated Notes represented by the IDSs vote together as a single class in proportion to the aggregate principal amount of the Subordinated Notes they hold. The completion of the offering of Separate Subordinated Notes was a condition of the Issuer's offering of the IDSs.

NFL Holdings issued Class A common shares ("Class A Shares") to NFI in the amount of \$66,320 and, in turn, used the proceeds to acquire a 100% interest in THI and its subsidiaries through (i) NFL Holdings acquiring a majority of the outstanding shares and warrants of THI, (ii) THI purchasing for cancellation a portion of the existing THI options ("Existing Options") with the remainder of the Existing Options addressed as described below, and (iii) New Flyer Transit L.P. (the "Continuing Investor") exchanging its remaining shares and warrants of THI upon expiry of the over-allotment option into shares of NFL Holdings. The remainder of the net proceeds, plus certain amounts drawn under the Credit Facility (as defined below), were used to repay the existing indebtedness of THI and to pay certain other transaction costs. The former principal holder of shares and warrants of THI, being the Continuing Investor, together with New Flyer LLC ("NFL LLC") acquired 100% of the Class B common shares of NFL Holdings ("Class B Shares") and 100% of the Class C common shares of NFL Holdings ("Class C Shares").

An aggregate payout of \$17,146 was made to the existing management optionholders ("Management Optionholders") and the existing director optionholders (the "Director Optionholders") to cancel a portion of the Existing Options. The remaining Existing Options of THI, held by Management Optionholders, were exchanged for options to acquire non-voting units of NFL LLC (the "New Options"). The New Options have a nominal exercise price and vested immediately after closing of the Offering (the "Closing"). The New Options effectively transfer the economic rights of Class B Shares and Class C Shares held by NFL LLC to the Management Optionholders.

The acquisition of THI was accounted for using the purchase method.

NEW FLYER HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION (Continued)

Contemporaneously with the Closing, NFI ULC and NFAI entered into a senior credit facility (the "Credit Facility") which provided a \$90,000 secured term loan facility (fully drawn at Closing), a \$35,000 secured revolving credit facility (undrawn at Closing) and a \$45,000 letter of credit facility (drawn at \$15,283 at Closing). Upon completion of the Offering and the related transactions, \$147,632 was used to repay the amounts owing under THI's existing senior credit facility and certain other existing indebtedness.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements of NFL Holdings are prepared in accordance with generally accepted accounting principles in Canada and are presented in U.S. dollars, representing the functional currency of the Company. The following is a summary of significant accounting policies of the Company:

Basis of consolidation

These consolidated financial statements include the accounts of the Company and its respective subsidiaries as disclosed in note 1. All significant intercompany transactions and accounts have been eliminated.

Fiscal period

The Company's 2005 fiscal period is based on four 13-week quarters as follows:

<u>Quarter</u>	<u>Period End Date</u>	<u>Weeks in the Period</u>
Quarter 1	—	— (a)
Quarter 2	July 3, 2005	— (a)
Quarter 3	October 2, 2005	6 (a)
Quarter 4	January 1, 2006	<u>13</u>
		<u>19</u>

a) As disclosed in note 1, the Company was incorporated on June 21, 2005; however, it commenced operations on August 19, 2005 upon the acquisition of THI.

Use of estimates

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts at the date of, and for the period of, the financial statements. Actual results could differ from those estimates. Estimates are reviewed on a regular basis and, as adjustments become necessary, they are reported in income in the periods in which they become known. The assets and liabilities which require management to make significant estimates and assumptions in determining carrying values include inventories, intangible assets, goodwill, provision for warranty costs, accrued benefit liability and future income taxes.

Revenue recognition

The Company recognizes revenue when: 1) persuasive evidence of an agreement exists; 2) goods are delivered to the customer site; 3) the sales price is fixed or determinable; and 4) collection of the resulting receivable is reasonably assured.

Proceeds received from customers prior to the revenue recognition criteria being satisfied are deferred on the consolidated balance sheet as deferred revenue.

NEW FLYER HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Purchase accounting

The Company uses the purchase method of accounting for business combinations. At the date of acquisition the purchase price is allocated to the fair value of the identifiable assets acquired and the liabilities assumed. The excess of the purchase price over the fair value assigned to identifiable assets and liabilities acquired is recorded as goodwill.

Cash and cash equivalents

Cash and cash equivalents include commercial paper investments with maturities of less than six months and other highly marketable investments.

Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined on a first-in, first-out basis.

Property, plant and equipment

Property, plant and equipment is recorded at cost reduced by applicable investment tax credits, less accumulated amortization. Amortization is calculated at the following annual rates:

Building and building improvements.....	4% declining-balance basis
Machinery and equipment.....	25% declining-balance basis
Demonstrator buses	50% straight-line basis
Computer hardware and software	30% declining-balance basis
Office equipment.....	20% declining-balance basis

Amortization of equipment under capital lease is provided for either on the basis and the rates as noted above or over the term of the capital lease.

Leases of property, plant and equipment on terms that transfer substantially all of the benefits and costs of ownership are accounted for as capital leases. All other leases of property, plant and equipment are accounted for as operating leases.

Deferred charges

Deferred charges include expenditures related to the issuance of debt and directly associated with obtaining certain financing, including closing costs, professional fees and other related costs. Deferred charges are amortized on a straight-line basis over the term of the related debt as follows:

Debt financing costs	4 – 15 years
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Amortization of deferred charges is included in interest expense in the statement of operations.

NEW FLYER HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Definite-life intangible assets

Intangible assets that are deemed to have a definite life are amortized using the straight-line method over the estimated useful lives of the assets as follows:

Patents.....	13 years
Customer relationships	17 years

Indefinite-life intangible assets

Intangible assets that are deemed to have an indefinite life are not amortized, but rather are tested for impairment on an annual basis. Should the carrying amount of the intangible asset exceed its fair value, an impairment loss would be recognized at that time. The New Flyer trade name intangible asset (note 8) has been deemed to have an indefinite life.

Impairment of long-lived assets

Long-lived assets are tested for impairment whenever the circumstances indicate that the carrying value may not be recoverable. When events or circumstances indicate that the amount of long-lived assets are not recoverable, the long-lived assets are tested for impairment by comparing the estimate of future undiscounted cash flows to the carrying amount of the assets or group of assets. If the carrying amount is not recoverable from these future expected cash flows, any loss is measured as the amount by which the assets' carrying value exceeds fair value. Recoverability is assessed relative to undiscounted cash flows for the direct use and disposition of the assets or group of assets.

Goodwill

Goodwill represents the excess of the purchase price over the fair value assigned to identifiable assets and liabilities acquired. The Company assesses annually whether there has been an impairment in the carrying value of goodwill based on the fair value of its reporting units. Should the carrying amount of the goodwill exceed its estimated fair value, an impairment loss would be recognized at that time and charged to the statement of operations.

Warranty

At the time of sale, a provision for warranty claims is recorded and charged against operations. This warranty provision is based upon management's best estimate of expected future warranty costs utilizing past claims experience. Actual warranty expenditures are charged against the provision as incurred.

Foreign currencies

Amounts denominated in a foreign currency are translated to U.S. dollars as follows:

Monetary balances, including cash, accounts receivable, deposits, future income tax assets and liabilities, accounts payable and accrued liabilities, provision for warranty costs, accrued benefit liability, obligations under capital lease, and long-term debt, at the period end exchange rate.

Non-monetary balances, including inventories, prepaid expenses, property, plant and equipment, deferred charges, intangible assets, goodwill and deferred revenue, at the exchange rate prevailing at the date of the transaction.

NEW FLYER HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue and expenses, at the rate of exchange prevailing at the time of the transaction.

Foreign subsidiaries, all of which are integrated, are accounted for under the temporal method. Under this method, monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Non-monetary assets are translated at historical rates. Revenue and expenses are translated at average rates for the period.

Exchange gains or losses on translation of foreign currencies are included in net earnings.

Financial instruments and derivative financial instruments

The Company's financial assets and liabilities are initially recorded at the exchange amount of the related transaction, which is normally historical cost. When the carrying amount of a financial asset exceeds its fair value on a basis which is other than temporary, the fair value of the asset is recorded.

The Company follows Emerging Issues Committee Abstract 128 — "Accounting for Trading, Speculative, or Non-Hedging Derivative Financial Instruments" ("EIC 128"). For derivative financial instruments that do not qualify for hedge accounting or are entered into for trading or speculative purposes, EIC 128 requires that these derivative financial instruments be measured at fair value, with changes in fair value recognized currently in net earnings. Under the Company's risk management policy, derivative financial instruments are used only for risk management purposes, not for generating trading profits. To the extent that a derivative financial instrument does not qualify for hedge accounting, changes in the fair value of derivative financial instruments are recorded in the net earnings.

Employee future benefits

The funded status of the defined benefit plan is based on the value of the pension plan's assets and an actuarial valuation of the plan's liabilities. Pension plan assets are measured at fair value as at the period end date. The determination of the accrued benefit liability for the pension plan uses the projected benefit method prorated on service, a market discount rate at the period end date and the expected long-term rate of return on plan assets based on long-term corporate bond rates.

The pension expense for the defined benefit plan is a combination of the current service cost (the value of benefits earned in the year), the interest earned or charged to the assets and liabilities, and any amortization of past service costs (due to plan amendments) and actuarial gains and losses (due to changes in assumptions and plan experience). Both past service costs and actuarial gains and losses are amortized on a straight-line basis over the expected average remaining service lives of plan members. Past service costs are amortized beginning in the year following the plan amendment. Only the cumulative unrecognized net actuarial gains and losses in excess of 10% of the greater of the projected benefit obligation or the fair value of the plan assets are amortized and reflected in the pension expense.

The pension expense for the defined contribution plans is the annual funding contribution required by the Company.

NEW FLYER HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are recognized for temporary differences between the accounting and tax bases of the Company's assets and liabilities, and are measured using substantively enacted tax rates that are expected to be in effect when the differences are settled. The effect of the changes in income tax rates is recognized in the year in which the rate-change is considered substantively enacted. The income tax provision represents income taxes paid or payable for the current year plus the change in the future income taxes during the year. A valuation allowance is provided against future income tax assets when it is more likely than not that all or some portion of the future income tax assets will not be realized.

Asset retirement obligations

The Company follows CICA Handbook Section 3110, "Asset Retirement Obligations". The standard provides guidance for the recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement cost. The standard applies to legal obligations associated with the retirement of a tangible long-lived asset and applies to obligations for both lessors and lessees in connection with leased assets. Under the standard, the fair value of liabilities for asset retirement obligations is recognized in the period it is incurred. A corresponding increase to the carrying amount of the related asset is recorded and amortized over the life of the asset. The obligations are accreted to full value over time through charges to income.

Recently issued accounting pronouncements

The following recently issued accounting pronouncements represent a summary of the pronouncements that are likely to, or may at some future time, have an impact on the Company.

Financial Instruments — Recognition and Measurement, Handbook Section 3855

Section 3855 prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the balance sheet and at what amount, in certain instances using fair value and in others using cost-based measures. It also specifies how financial instrument gains and losses are to be presented.

Section 3855 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Earlier adoption is permitted only as of the beginning of a fiscal year ending on or after December 31, 2004. The Company plans to adopt this standard for its 2007 fiscal year or earlier. Transitional provisions for this Section are complex and vary based on the type of financial instrument under consideration.

The Company is currently evaluating the impact of adopting this standard.

Comprehensive Income, Handbook Section 1530

Section 1530 introduces a new requirement to temporarily present certain gains and losses outside net income.

Section 1530 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Earlier adoption is permitted only as of the beginning of a fiscal year ending on or after December 31, 2004. The Company plans to adopt this standard for its 2007 fiscal year or earlier. Financial statements of prior periods are required to be restated for certain comprehensive income items. In addition, an enterprise is encouraged, but not required, to present reclassification adjustments in comparative financial statements provided for earlier periods.

The Company is currently evaluating the impact of adopting this standard.

NEW FLYER HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Hedges — Handbook Section 3865

Section 3865 establishes standards for when and how hedge accounting may be applied. Hedge accounting is optional. This Section applies for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Retroactive application is not permitted. Earlier adoption is permitted only as of the beginning of a fiscal year that ends on or after December 31, 2004.

The Company is currently evaluating the impact of adopting this standard.

3. ACQUISITION OF THI

The acquisition of THI has been accounted for using the purchase method. The fair values of the identifiable assets and liabilities acquired have been based on management's best estimates and valuation techniques as at August 19, 2005. The cash purchase price of \$62,274 and non-cash consideration consisting of Class B Shares and Class C Shares of \$277,287 were allocated to the assets and liabilities of THI at August 19, 2005 as follows:

Assets acquired

Cash.....	\$ 11,176
Accounts receivable.....	48,390
Inventories.....	81,468
Prepaid expenses and deposits	7,886
Property, plant and equipment.....	32,070
Deferred charges.....	1,580
Intangible assets	389,900
Goodwill	201,083
Derivative financial instruments.....	<u>757</u>
	<u>\$ 774,310</u>

Liabilities assumed

Accounts payable and accrued liabilities	\$ 126,551
Deferred revenue	15,691
Provision for warranty costs.....	19,675
Accrued benefit liability	3,288
Obligations under capital lease.....	1,662
Future income tax liabilities (net).....	120,250
Long-term debt	<u>147,632</u>
	<u>434,749</u>
Total purchase price	<u>\$ 339,561</u>
Consideration represented by:	
Cash paid.....	\$ 62,274
Other liability, Class B and C common shares (note 11).....	<u>277,287</u>
	<u>\$ 339,561</u>

Intangibles principally represent the values of patents and customer relationships, in the amounts of \$88,200 and \$170,900, respectively, that will be amortized over the remaining lives of those intangibles, and trade names in the amount of \$130,800, with an indefinite-life that will not be amortized but tested annually for impairment.

After allocating the cost of the purchase to identifiable assets and liabilities, goodwill in the amount of \$201,083 was recorded. No amount of this goodwill is expected to be deductible for tax purposes.

NEW FLYER HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

4. ACCOUNTS RECEIVABLE

	<u>January 1, 2006</u>
Trade	\$ 35,534
Income tax	9,007
Other	<u>2,979</u>
	<u>\$ 47,520</u>

5. INVENTORIES

	<u>January 1, 2006</u>
Raw materials	\$ 27,762
Work in process.....	17,168
Finished goods.....	<u>28,091</u>
	<u>\$ 73,021</u>

6. PROPERTY, PLANT AND EQUIPMENT

	<u>January 1, 2006</u>		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
Land	\$ 1,422	\$ —	\$ 1,422
Building and building improvements.....	7,996	118	7,878
Machinery and equipment.....	14,616	1,319	13,297
Demonstrator buses	430	80	350
Computer hardware and software	5,922	654	5,268
Office equipment	349	25	324
Under capital lease			
Computer hardware	649	56	593
Equipment.....	<u>3,294</u>	<u>157</u>	<u>3,137</u>
	<u>\$ 34,678</u>	<u>\$ 2,409</u>	<u>\$ 32,269</u>

7. DEFERRED CHARGES

	<u>January 1, 2006</u>
Debt financing costs	<u>\$ 13,442</u>

Amortization of \$480 for the period ended January 1, 2006 has been deducted to arrive at the carrying amount of deferred charges.

NEW FLYER HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

8. INTANGIBLE ASSETS

	January 1, 2006		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Carrying Amount</u>
Definite-life intangible assets:			
Patents	\$ 88,200	\$ 2,499	\$ 85,701
Customer relationships	170,900	3,702	167,198
Indefinite-life intangible assets:			
Trade names	<u>130,800</u>	<u>—</u>	<u>130,800</u>
	<u>\$ 389,900</u>	<u>\$ 6,201</u>	<u>\$ 383,699</u>

The intangible asset amortization expense recorded during the period ended January 1, 2006 was \$6,201.

9. OBLIGATIONS UNDER CAPITAL LEASE

The Company has entered into capital leases for equipment, computer hardware and software licenses, with imputed interest rates between 2.28% and 20.70%, expiring between 2006 and 2013. The following is a schedule of future minimum lease payments, together with the balance of the obligation under the capital leases as at January 1, 2006:

2006	\$ 985
2007	809
2008	682
2009	507
2010	488
Thereafter	<u>705</u>
	4,176
Less: Amounts representing interest	<u>546</u>
	3,630
Less: Current portion	<u>810</u>
	<u>\$ 2,820</u>

10. LONG-TERM DEBT

	<u>Final Maturity</u>	<u>January 1, 2006</u>
Subordinated Notes included in the IDS issue (a) (C\$110,600)	2020	\$ 95,099
Separate Subordinated Notes (b) (C\$33,300)	2020	28,633
Term Credit Facility (c)	2009	<u>90,000</u>
		<u>\$ 213,732</u>

There are no principal repayments required on long-term debt within the next five years except for the Term Credit Facility to be repaid in 2009.

- (a) Included in the Offering, forming part of IDSs, were C\$110,600 of 14%, Subordinated Notes. NFI ULC has the option to redeem all or a portion of the Subordinated Notes on or after the seventh anniversary of the Closing, for cash, at a redemption price equal to a premium over the principal amount of the Subordinated Notes together with accrued and unpaid interest, if any.

NEW FLYER HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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10. LONG-TERM DEBT (Continued)

The Subordinated Notes are subordinated in right of payment to all existing and future senior indebtedness of NFI ULC and are senior in right of payment to any subordinated indebtedness of NFI ULC.

Except for a tax redemption, NFI ULC may not redeem the Subordinated Notes at its option prior to the seventh anniversary of the Closing. On or after the seventh anniversary of the Closing, NFI ULC may redeem the Subordinated Notes at its option, at any time in whole and from time to time in part, upon not less than 30 nor more than 60 days' notice to holders, for cash, at a redemption price (expressed as percentages of principal amount) set forth below, plus accrued and unpaid interest on the Subordinated Notes redeemed to the applicable redemption date, if redeemed during the 52-week period beginning on the anniversary date of the Closing during the years indicated below:

Year	Percentage
2012	105%
2013	104%
2014	103%
2015	102%
2016	101%
2017 and thereafter	100%

The Subordinated Notes are an unsecured obligation of NFI ULC and are guaranteed by NFAI on an unsecured basis.

Fees associated with the issuance of the Subordinated Notes of \$9,381 were recorded as deferred financing costs and are being amortized over the term of the Subordinated Notes.

- (b) NFI ULC issued C\$33,300 of 14% Separate Subordinated Notes, under the same terms and conditions as the Subordinated Notes included in the Offering, described in (a) above. The Separate Subordinated Notes and the Subordinated Notes (forming part of IDSs) were issued under the same indenture and the holders will vote together as a single class in proportion to the aggregate principal amount of Subordinated Notes they hold on all matters on which they are eligible to vote under the indenture.

Fees associated with the issuance of the Separate Subordinated Notes of \$2,216 were recorded as deferred financing costs and are being amortized over the term of the Separate Subordinated Notes.

- (c) The four-year Credit Facility includes a \$90,000 secured term loan facility, of which \$90,000 was drawn at January 1, 2006, up to a \$40,000 (amended to increase by \$5,000 post Closing) secured revolving credit facility (with no drawings at January 1, 2006) and up to a \$50,000 letter of credit facility (amended to increase by \$5,000 post Closing), which was drawn at \$11,518 at January 1, 2006. Fees associated with the arrangement of the Credit Facility were \$2,325 and were treated as deferred financing costs, which are being amortized over the term of the Credit Facility.

NEW FLYER HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
January 1, 2006
(in thousands of U.S. dollars except per share figures)

10. LONG-TERM DEBT (Continued)

The obligations in respect of the Credit Facility are secured by: (A) a perfected lien on, and pledge of, (i) all of the capital stock of, and intercompany notes owing to, THI and (ii) all of the capital stock of, and inter-company notes owing to, all of THI's existing and future direct and indirect subsidiaries (other than NFL LLC) (collectively, the "Guarantors"), and (B) a perfected lien on, and security interest in, all of the existing and future tangible and intangible properties and assets of (i) NFI ULC, (ii) NFAI, (iii) THI and (iv) each of the Guarantors, with certain exceptions. The Company has provided a limited recourse guarantee of the obligations under the Credit Facility secured by its capital stock in THI, and NFI, though not a guarantor of the Credit Facility, entered into a collateral covenant agreement.

Loans under the Credit Facility bear interest at a rate equal to LIBOR or a U.S. base rate for loans denominated in U.S. dollars and a Canadian prime rate or bankers' acceptance rate for loans denominated in Canadian dollars, plus an applicable margin to those rates.

11. OTHER LIABILITIES, CLASS B AND C COMMON SHARES

Authorized (000s)

3,000	Class B Shares, par value of \$0.01 per share, further described in points (i) and (ii) below.
35,000	Class C Shares, par value of \$0.01 per share, further described in points (i) and (ii) below.

Issued (000s)

2,562	Class B Shares	\$ 19,560
31,586	Class C Shares	<u>241,090</u>
		<u>\$ 260,650</u>

A summary of changes to the carrying value of the liability related to these shares is as follows:

	<u>Class B Shares</u>	<u>Class C Shares</u>	<u>Total</u>
Fair value at the date of issue (a).....	\$ 20,808	\$ 256,479	\$ 277,287
Fair value adjustment (b)	<u>(1,248)</u>	<u>(15,389)</u>	<u>(16,637)</u>
Fair value at January 1, 2006	<u>\$ 19,560</u>	<u>\$ 241,090</u>	<u>\$ 260,650</u>

- a) On August 19, 2005 and in connection with the Offering the Company issued 2,562,529 Class B Shares and 31,585,671 Class C Shares in exchange for common shares, warrants and options of THI having a fair value of \$277,287.
- b) During the period ended January 1, 2006, the Company recorded a reduction in value of Class B Shares and Class C Shares of \$1,248 and \$15,389, respectively, to reflect the current fair market value of these shares calculated in accordance with the provisions of the securityholders agreement governing NFL Holdings.

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11. OTHER LIABILITIES, CLASS B AND C COMMON SHARES (Continued)

During the period, the Company declared dividends of \$645 and \$7,943 to the holders of Class B Shares and Class C Shares, respectively.

- (i) Class B Shares and Class C Shares are entitled to fixed cumulative preferential cash dividends at the discretion of the Board, at a rate equal to 14% of the Liquidation Amount, defined below, per annum, or at such other rate as is in effect for interest payments on the Subordinated Notes decreased by a percentage equal to the combined U.S. federal and state corporate income tax rate applicable to the Company, to be paid before any dividends on the Class A Shares. Thereafter, dividends are payable to the holders of Class A, B and C Shares pro rata unless and until the Enhanced Dividend, defined below, becomes payable and, thereafter, pro rata taking into account the Enhanced Dividend, which is non-cumulative and may only be paid to holders of Class B and C Shares in respect of any month if the Company has declared and paid dividends on the Class A Shares at not less than the monthly amount of \$0.027 per share (adjusted for taxes) for such month. In the event of the winding up of the Company, the Class B and C Shares are entitled to receive the sum of C\$5.53 per share (the "Liquidation Amount") and accrued and unpaid dividends before the remaining assets are distributed ratably among the Class A, B and C Shares. Distributions on the Class B Shares are subordinated in favour of distributions on the Class A and C Shares for the period from the date of Closing until certain conditions have been met.
- (ii) The Continuing Investor and NFL LLC own all of the issued and outstanding Class B Shares and Class C Shares and also have the right, in certain circumstances, to request NFL Holdings to use its best efforts to arrange a financing commitment in order to permit the acquisition or purchase for cancellation of the Class B Shares and the Class C Shares at fair market value (the "Liquidity Right"). It is expected that this will occur through the sale of additional IDSs or other securities. As a result, the Class B Shares and the Class C Shares have been classified as a liability of NFL Holdings and are recorded at fair value on the consolidated balance sheet. The liability is revalued to fair value at each balance sheet date in accordance with the valuation principles set out in the NFL Holdings securityholders agreement.

In the event that the Liquidity Right is exercised and not successful, a portion of the dividend paid in respect of those Class B Shares and Class C Shares will be increased relative to the dividend paid on the Class A Shares (the "Enhanced Dividend"). The Company has the right to redeem the shares (the "Redemption Right") subject to the Enhanced Dividend for fair market value.

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12. SHARE CAPITAL

Authorized (000s)

63,000 Class A Shares, voting, non-cumulative dividends at the discretion of the Board, par value of \$0.01 per share.

Issued (000s)

20,000 Class A Shares \$ 66,320

The following is a summary of changes to the issued and outstanding capital stock during the period:

	<u>Number of Shares</u>	<u>Amount</u>
Class A Shares		
Balance — August 19, 2005	—	\$ —
Class A Shares issued for cash consideration	<u>20,000</u>	<u>66,320</u>
Balance — January 1, 2006	<u>20,000</u>	<u>\$ 66,320</u>

During the period, the Company declared dividends of \$2,163 to the holders of Class A Shares.

13. CHANGES IN NON-CASH WORKING CAPITAL ITEMS

	<u>January 1, 2006</u>
Accounts receivable	\$ 1,300
Inventories	9,356
Prepaid expenses and deposits	(216)
Accounts payable and accrued liabilities	(36,410)
Deferred revenue	1,688
Provision for warranty costs	(758)
Impact of foreign exchange translation	<u>(355)</u>
	<u>\$ (25,395)</u>

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14. INCOME TAXES

The reconciliation of income tax attributable to continuing operations, computed at the statutory rates, to income tax expense is as follows:

	Period from August 19, 2005 to January 1, 2006
Earnings before income tax expense	\$ 695
Combined statutory rate	<u>37.8%</u>
 Tax expense based on statutory rate	 263
Non-deductible expenses	78
Benefit of unrecognized loss carry-forwards.....	(526)
Impact of foreign tax credits utilized	(6,596)
Distributions on Class B and C common shares treated as interest expense	3,246
Impact of other liabilities, Class B and C common shares fair value adjustment.....	(6,289)
Withholding and other taxes	510
Other	<u>(1,069)</u>
 Provision for income taxes (recovery).....	 <u>\$ (10,383)</u>
 Comprised of:	
Current income taxes.....	\$ 3,400
Future income taxes (recovery).....	<u>(13,783)</u>
 Provision for income taxes (recovery).....	 <u>\$ (10,383)</u>

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14. INCOME TAXES (Continued)

Significant components of the future tax assets and liabilities at the period end are as follows:

	<u>January 1, 2006</u>
Future income tax assets	
Accounts payable and accrued liabilities	\$ 2,520
Inventory and warranty reserves	8,499
Non-capital losses carried forward.....	703
Other assets	2,401
Accrued benefit liability	323
Intercompany profit elimination and other assets	1,041
Foreign tax credit pool.....	<u>33,656</u>
Future income tax assets.....	<u>49,143</u>
Future income tax liabilities	
Accounts payable and accrued liabilities	(1,448)
Property, plant and equipment	(3,649)
Intangible assets.....	(140,050)
Deferred financing costs.....	(208)
Other assets	<u>(595)</u>
Future income tax liabilities	<u>(145,950)</u>
Net future income tax liability.....	<u>\$ (96,807)</u>
Recorded as	
Current future income tax assets	\$ 11,812
Non-current future income tax assets.....	33,332
Non-current future income tax liabilities	<u>(141,951)</u>
	<u>\$ (96,807)</u>

The Company has U.S. federal non-capital loss carry-forwards of approximately \$937, and various U.S. state loss carry-forwards, which may be applied against future taxable income. The U.S. federal tax loss carry-forwards expire as follows:

	<u>Loss Carry- Forwards</u>
2022	\$ 937

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14. INCOME TAXES (Continued)

Annually, the Company reviews the likelihood of realization of the future benefits of these tax loss carry-forwards. In management's opinion, the criteria for recording the net future income tax assets has been met this period. Accordingly, the income tax benefit of these loss carry-forwards has been fully recorded. However, these losses are restricted in application to \$55 per annum as a result of a past acquisition of the Company.

NFI ULC has withheld Canadian withholding tax in the amounts of \$3,251 and \$9,268 as the result of the payment of a dividend to THI and as a result of a transfer of shares to THI, respectively. This share transfer for partial debt consideration results in a deemed dividend for Canadian tax purposes subject to Canadian withholding tax. The tax withheld is treated as a foreign tax credit in NFL Holdings. The U.S. foreign tax credit can be carried forward for a period of 10 years and, subject to certain limitations, can be applied to reduce U.S. taxes attributable to foreign source income.

15. FINANCIAL INSTRUMENTS

In addition to recorded financial instruments arising from operations and the financing of operations, the Company has derivative financial instruments to manage its risks associated with adverse changes in interest rates and foreign exchange rates.

The Company does not hold financial instruments for speculative or trading purposes. The Company has elected not to apply hedge accounting to its derivative financial instruments.

Interest rate risk and foreign exchange management

The Company entered into a cross-currency interest rate swap with an initial notional principal amount of C\$108,000 at 7.13%, maturing on August 19, 2009, to manage interest rate risk relating to adverse changes in the LIBOR rate on the Term Credit Facility and estimated foreign exchange risk from future operations. The fair value of the cross-currency interest rate swap at January 1, 2006 is \$(149) and has been recorded in net earnings for the reported period. The related liability is recorded on the balance sheet in derivative financial instruments liability.

The Company has entered into forward contracts to buy United States dollars with Canadian dollars at an agreed exchange rate.

The total notional amounts of these forward contracts at January 1, 2006 are C\$23,930 and the effective exchange rate is 0.8696. The forward dates in the contracts range from January 12, 2006 to January 12, 2007. At January 1, 2006 the fair value of these forward contracts was \$135 and was recorded in net earnings for the reported period. The related receivable is included in accounts receivable.

Fair values

The carrying amounts reported in the consolidated balance sheet for cash, accounts receivable (subject to normal trade terms), deposits and accounts payable and accrued liabilities approximates fair value due to the immediate or short-term maturities of these financial instruments.

The carrying amount of obligations under capital leases approximates fair value.

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15. FINANCIAL INSTRUMENTS (Continued)

The carrying value of the Term Credit Facility approximates fair value because the interest rate is variable. All other debt of the Company bears interest at fixed rates. Estimated fair value amounts as at January 1, 2006 for these financial instruments are as follows:

	Carrying Amount	Fair Value
Subordinated Notes included in the IDS issue	\$95,099	\$95,389
Separate Subordinated Notes	28,633	28,720

Credit risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of accounts receivable, cash and derivatives. Management has assessed that the credit risk associated with accounts receivable is mitigated by the significant revenue it receives from a number of well established customers. Additionally, the U.S. federal government funds a substantial portion of U.S. customer payments. The risk associated with the Company's cash balance is mitigated by the fact that this amount is placed with commercial financial institutions.

The counterparties to the Company's derivatives are significant financial institutions. The Company could be exposed to loss in the event of non-performance by the counterparty. However, credit ratings and concentration of risk of the financial institutions are monitored on an ongoing basis.

16. SEGMENT INFORMATION

The Company has two operating segments: Bus Operations and Aftermarket Operations.

The Bus Operations segment derives its revenue from the manufacture of heavy-duty transit buses for public transportation. The Aftermarket Operations segment derives its revenue from the provision of service parts and servicing related to heavy-duty transit buses. These operating segments are consistent with the management of the business, which is based on the products and services offered.

There is no inter-segment revenue. Unallocated items in the consolidated earnings before income taxes primarily include foreign exchange gains or losses, loss on disposition of property, plant and equipment, amortization of property, plant and equipment, amortization of intangible assets, interest expense, gains and losses on the Company's cross-currency interest rate swap and distributions on Class B Shares and Class C Shares. Corporate overhead costs are allocated fully to the Bus Operations segment.

The unallocated total assets of the Company primarily include cash, intangible assets, future income tax assets, and deferred charges.

Corporate assets that are shared by both operating segments are allocated fully to the Bus Operations segment.

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16. **SEGMENT INFORMATION (Continued)**

Segment information about profits and assets is as follows:

	Period from August 19, 2005 to January 1, 2006			
	Bus Operations	Aftermarket Operations	Unallocated	Total
Revenue from external customers	\$ 189,574	\$ 19,374	\$ —	\$ 208,948
Operating costs and expenses	178,257	15,669	—	193,926
Earnings (loss) before income taxes	11,317	3,705	(14,327)	695
 Total assets	 290,401	 71,609	 463,662	 825,672
Capital expenditures	845	16	—	861
Goodwill	147,398	53,685	—	201,083

The allocation of revenue to geographic areas is as follows:

	Period from August 19, 2005 to January 1, 2006
United States	\$135,820
Canada	<u>73,128</u>
Total	<u>\$208,948</u>

The allocation of property, plant and equipment to geographic areas is as follows:

	January 1, 2006
United States	\$ 7,212
Canada	<u>25,057</u>
Total	<u>\$ 32,269</u>

During the period, the Company had revenue from certain customers that was individually greater than 10% of the Company's revenue.

Details with respect to consolidated revenue from these customers and the number of customers are as follows:

	Period from August 19, 2005 to January 1, 2006
Revenue from customers greater than 10% of the consolidated revenue	\$ 51,865
Number of customers	2

The revenue from these customers principally consists of revenue from the Bus Operations segment.

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17. RELATED PARTY TRANSACTIONS

Due to New Flyer Industries Inc	\$ 301
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This amount is non-interest bearing and has no terms of repayment.

18. EMPLOYEE FUTURE BENEFITS

Defined benefit plan

The Company's subsidiary, NFI ULC, has a defined benefit plan which covers unionized employees. An actuarial valuation was last performed as at December 31, 2004. The date at which the Company measures its fair value of plan assets and accrued benefit obligations is December 31 of each year.

Information in respect of the Company's defined benefit plan is as follows:

	Period from August 19, 2005 to January 1, 2006
Change in plan assets	
Plan assets at fair value — beginning of period	\$ 9,870
Actual return on plan assets	402
Employer's contributions	539
Employee contributions	—
Benefits paid	(154)
Foreign exchange	<u>420</u>
Plan assets at fair value — end of period	<u>11,077</u>
Change in accrued benefit obligation	
Accrued benefit obligation — beginning of period	13,158
Current service cost	308
Interest cost	282
Employee contributions	—
Benefits paid	(154)
Actuarial loss	701
Foreign exchange	<u>561</u>
Accrued benefit obligation — end of period	<u>14,856</u>
Funded status — plan deficit	(3,779)
Unamortized actuarial losses	<u>578</u>
Accrued benefit liability	<u>\$ (3,201)</u>

Subsequent to January 1, 2006 the Company made a voluntary contribution of \$2,324 to the defined benefit plan.

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18. EMPLOYEE FUTURE BENEFITS (Continued)

The significant weighted average actuarial assumptions adopted in measuring the Company's accrued benefit obligation and net pension plan expense are as follows:

	Period from August 19, 2005 to January 1, 2006
Accrued benefit obligation	
Discount rate.....	5.25%
Pension plan expense	
Discount rate.....	5.50%
Expected long-term rate of return on plan assets.....	7.00%

The Company plan is a fixed benefit plan and, as a result, the rate of compensation increases does not have any impact on the actuarially determined accrued benefit liability.

The Company's net pension plan expense is as follows:

	Period from August 19, 2005 to January 1, 2006
Current service costs.....	\$ 308
Interest cost on accrued benefit obligations.....	282
Actual return on assets	(402)
Actuarial losses on accrued benefit obligations.....	701
Pension cost before adjustments to recognize long-term nature of the plan.....	889
Difference between expected and actual return on plan assets	129
Difference between actuarial loss recognized and actual actuarial loss on benefit obligation.....	(701)
Adjustments to recognize the long-term nature of the plan.....	(572)
Pension cost for the period.....	<u>\$ 317</u>

An analysis of the assets of the plan by investment category is provided as follows:

	January 1, 2006
Asset category	
Cash and cash equivalents.....	0.0%
Canadian equities.....	20.3%
Foreign equities	30.0%
Bonds	49.7%
	<u>100.0%</u>

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18. EMPLOYEE FUTURE BENEFITS (Continued)

Defined contribution pension plans

In the United States, the Company maintains two savings retirement plans (401(k) plans). In Canada, the Company maintains a defined contribution plan for salaried employees. The net pension expense for the Company's defined contribution plans is as follows:

	Period from August 19, 2005 to January 1, 2006
Defined contribution pension expense.....	\$ 385

Cash payments contributed by the Company during the period for its defined benefit and defined contribution pension plans amounted to \$898.

19. COMMITMENTS AND CONTINGENCIES

(a) Operating lease commitments

The Company has leased real property with aggregate minimum lease payments of \$37,104 payable as follows:

2006	\$ 2,426
2007	1,998
2008	2,034
2009	2,071
2010	1,733
Thereafter.....	<u>26,842</u>
	<u>\$ 37,104</u>

(b) In the normal course of business, the Company receives notice of potential legal proceedings or is named as a defendant in legal proceedings, including those related to product liability, wrongful dismissal or personal injury. Many claims are covered by the Company's insurance policies and none of the current claims are expected to have a material adverse effect on the Company's financial position, results of operations or cash flows.

(c) Through the normal course of operations, the Company has indemnified the surety companies providing surety bonds required under various contracts with customers. In the event that the Company fails to perform under a contract and the surety companies incur a cost on a surety bond, the Company is obligated to repay the costs incurred in relation to the claim up to the value of the bond. The Company's guarantee under each bond issued by the surety companies expires on completion of obligations under the customer contract to which the bond relates. The estimated maturity dates of the surety bonds outstanding at January 1, 2006 range from November 2006 to January 2008.

At January 1, 2006, outstanding surety bonds guaranteed by the Company totaled \$35,004. The Company has not recorded any liability under these guarantees as management believes that no material events of default exist under any contracts with customers.

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19. COMMITMENTS AND CONTINGENCIES (Continued)

- (d) During the period, the Company increased its letter of credit facility from \$45,000 to \$50,000. As at January 1, 2006, letters of credit totaling \$11,518 remain outstanding under the letter of credit facility as security for the following contractual obligations of the Company:

Collateral to secure operating facility leases.....	\$ 523
Collateral to secure surety facilities	8,958
Customer performance guarantees.....	656
Collateral in support of self-insured workers' compensation obligations.....	1,381

As at January 1, 2006, management believes that the Company is in compliance in all material respects with all applicable contractual obligations and the Company has not provided for any costs associated with these letters of credit.

20. GUARANTEES

The Company indemnifies its directors and officers against claims and damages that may be incurred in the performance of their services to the Company. Liability insurance has been purchased with respect to the Company's directors and officers.



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